# AN ALTERNATIVE TO ANNUALIZING THE COST-OF-LIVING ADJUSTMENTS ON FEDERAL RETIREMENT

## HEARING

BEFORE THE

SUBCOMMITTEE ON CIVIL SERVICE,
POST OFFICE, AND GENERAL SERVICES

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

**S. 677**

TO AMEND CHAPTER 83 OF TITLE 5 OF THE UNITED STATES CODE TO PROVIDE AN EQUITABLE SYSTEM OF COST-OF-LIVING ADJUSTMENTS FOR CIVIL SERVICE ANNUITANTS, AND FOR OTHER PURPOSES

APRIL 1, 1981

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# AN ALTERNATIVE TO ANNUALIZING THE COST-OF-LIVING ADJUSTMENTS ON FEDERAL RETIREMENT

WEDNESDAY, APRIL 1, 1981

U.S. SENATE,
SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE,
AND GENERAL SERVICES,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 8:08 a.m., in room 3302, Dirksen Senate Office Building, Senator Ted Stevens (chairman of the subcommittee) presiding.

Present: Senators Stevens and Pryor.

Staff present: Wayne Schley, staff director; Jamie Cowen, chief counsel; Knox Walkup, minority staff director; Pat Halcomb, chief clerk; Peter Fromuth, professional staff assistant; Merry Halamandaris, minority staff; Louis Light, minority staff; and Margaret Sims.

## OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. The subcommittee will come to order.

We are here this morning to hear testimony on S. 677, an alternative to annualizing the cost-of-living adjustments on Federal retirement income.

S. 677 provides that an annuitant under age 60 will see his annuity adjusted once a year at 50 percent of the Consumer Price Index. From ages 60 to 65 his annuity will be fully adjusted for inflation once a year. From age 65 and on, and for the disabled, the current semiannual adjustment formula applies.

The purpose of this bill is twofold. One, it offers an alternative to the once-a-year adjustment proposal. Two, it protects the most vulnerable segment of the retired population.

In addition, due to the enactment of certain provisions of last year's defense authorization bill, any changes made to the cost-of-living adjustment formula for civil service retirees may impact military retirees in the same manner.

Therefore, we have invited the Department of Defense and representatives from the retired military community to testify today.

Finally, as a traditional supporter of Federal employee and retiree issues, I recognize the strong feelings evoked by any hint of change to the retirement system. For many the retirement system was the reason they joined the service.

There have been suggestions, though, that the twice-a-year formula has become excessively and needlessly costly. It is true that

many, who retire at a relatively young age, take positions in the private sector and thus do not need full inflationary protection.

As you know, annualization of COLA is not a new concept. It was proposed by the previous administration and debated in past years. In fact, annualization almost succeeded last year. Today we face a darker reality. We are in the midst of a serious economic crisis. The Federal budget must be reduced.

As I said in my statement on the Senate floor when introducing this measure, the Civil Service Retirement System is one of the most worthy Federal programs. Yet, the twice-a-year formula is a red flag to the public's perception to cut the budget. If the formula must be changed, let us change it in a manner that will cushion the impact on the truly needy.

We have a series of witnesses this morning. I would ask that you limit your oral testimony, if you can, to 5 minutes.

Your full written testimony will be included in the record. You will note there is a timer in front of the witness table. When the yellow light goes on, there is 1 minute remaining. When the red light goes on, you will know that 5 minutes have passed.

Our first witness is Donald J. Devine, Director, Office of Personnel Management.

While Dr. Devine is coming to the table, let me again state that I do not have any pride in authorship so far as this bill is concerned. We are trying to see if there is some formula that we might adopt which will cushion the impact of the proposal for once-a-year readjustment so far as those who are most needy are concerned.

Senator Pryor has an opening statement which we will have inserted in the record at this point.

[Senator Pryor's opening statement follows:]

OPENING STATEMENT OF SENATOR PRYOR

Mr. Chairman, I want to commend you this morning for convening this hearing to consider the very important issue of cost-of-living adjustments for federal retirees. I know of your concern about this issue—a concern demonstrated by your introduction of S. 677—and I want to say that I am prepared to work as hard as I did in the last Congress to make sure that federal retirees are treated fairly, honorably, and with the respect they deserve.

Federal retirees want fairness. They want a decent standard of living at the end of their government service. They want the promises of government and government officials to be kept. They are articulate spokespersons for their cause and I would like to quote from their letters to me.

According to one retiree:

"We do not see our retirement plan as a bonus or a government give away program. We bought and paid for the plan, and the cost of providing payment to surviving spouses was included in the formula.

"Our image has been damaged by the ridiculous illustrations in the media of double dippers and fat cats. Actually the average retiree is already doing his share of belt-tightening. Most of us worked for modest wages and retired on a modest annuity. Unlike many others, we are still taxpayers. Increases in taxes, insurance, and all other prices in general are exceeding our COL adjustments even under the present semi-annual computation."

Another retiree said:

"Federal retirees return to the Treasury over ten percent of their annuities in the form of income tax."

One retiree pointed out that:

"If inflation were zero percent my retired pay would go up zero amount. My retired pay adjustment does not cause inflation; it just reflects inflation. Now the government wants to solve the inflation problem by taking it out of my hide, when I in no way contribute to inflation."

I hope Congress will listen attentively to the voices of retirees and be responsible and responsive in our actions.

Senator STEVENS. Dr. Devine?

## TESTIMONY OF DONALD J. DEVINE, DIRECTOR, OFFICE OF PERSONNEL MANAGEMENT, ACCOMPANIED BY GARY NELSON, ASSOCIATE DIRECTOR, COMPENSATION DIVISION

Mr. DEVINE. Thank you, Mr. Chairman.

It is a pleasure to be here this morning. With me today is Gary Nelson, the Associate Director of our Compensation Division.

I would like to make a few remarks on S. 677. I think your idea is a very interesting one. You are attempting to protect those who are potentially most vulnerable. You have divided the recipients into age groups to recognize changing needs during a person's life cycle. I would like to comment further on certain aspects of the proposal.

First, this bill is clearly an incentive to delay retirement. I think inclusion of a statement of purpose about encouraging later retirement would reduce the overall cost to the retirement system and keep it sound.

The President himself still is vigorously working in his 70's. Many more people choose not to retire early. This is a positive statement.

Second, for those who retire at 60, or 55, it would create a problem. It is offset, as you suggest in the bill, by the fact that the younger person can earn more. I think that does balance the problem.

The major difficulty, as we look at the figures, concerns the assumption that people over 65 are most negatively affected by the present system. That does not seem to be true according to the research within OPM.

As a matter of fact, it appears to us that the older retirees are doing relatively better than the younger retired.

Senator STEVENS. Is that not because they have been adjusted twice a year in the past, and they will not be adjusted twice in the future?

Mr. DEVINE. I do not think that is the main reason. At least in theory, a twice-a-year adjustment ends up raising annuities by the same amount as a once-a-year adjustment.

There is some overlap but presumably at the end of the year the price increase is the same whether you do it in two shots or one shot.

Senator STEVENS. It is compounded.

Mr. DEVINE. It is compounded, but the CPI compounds in the same way. The look-back provision is one reason for this.

Mr. NELSON. Senator, the main difference is that the cost-of-living adjustments which we have given to retirees have been greater than the pay increases for the employees.

Therefore, people who retired 10 years ago at a given amount of service are doing significantly better than those who retire today at the same amount of service.

Senator STEVENS. That is because we are under the cap. The problem is the reduction in the cost-of-living allowance for those who are still in Government service.

I do not see how you can look at that in terms of the future. This bill has a great impact out into future years.

I understand your comment. I think it probably is true. The former Speaker of the House demonstrates that more than anyone in terms of the pay he was receiving as compared with those who are still serving in the Congress.

That does not mean that in the future, as we adjust these benefits, that would remain the same. As a matter of fact, that is what we are trying to adjust, are we not? We are trying to prevent that.

Mr. NELSON. Senator, the problem in this particular case is that many who retired 10 years ago receive 35 percent more money than those who retire today after the same length of service.

Those who retire today under your bill at age 55 would only get 50 percent of the cost-of-living adjustments. In 10 years they would not only be 35 percent behind people who retired before, but could be over 60 percent behind people who retired 10 years before they did.

Senator STEVENS. I understand that.

There is no way to go back to take money away from those people who have been accumulating faster than those who are in Government service, unless we go back and pick up all of the cost-of-living adjustments that the people who are still in Government have not received and start adding the COLA on theirs once they retire.

But Congress has not done that. I doubt they will do it. You have to look at what happens from now on. You have just looked backward. We are trying to look forward.

I really do not understand OPM's analyzing this on the basis of what has happened in the past to discriminate against those who are working. We are talking about those who have retired.

Those who retire now—they have been discriminated against while they are working and the proposal that I think the administration supports as well as everyone else but me, is that you do away with the twice-a-year cost-of-living allowance. These are the people who will be hurt more than anyone. These are the ones who are currently working and will retire in the future.

Why not look at what happens to them in the future rather than what happened to them in the past?

Mr. DEVINE. We do not have evidence on that. It would be very difficult to ascertain. But there is no question, as I said earlier, that there are significant benefits to your approach.

You are right. You are talking about people now who will be older in the future. They will be behind those who have been in the civil service longer. There is no question about that.

There is one thing I am not sure about. Apparently the bill, S. 677, would apply the same three-tier system to all annuitants.

But some staff contacts suggest that the intent of the bill was to preserve the full semiannual adjustment for all disability annuitants.

If that is the intent, I see a significant problem resulting from large increases in the number of employees seeking to qualify for disability retirement as a way to receive higher benefits at the young age group, especially when we are under pressure to tighten up on the disability requirements.

I see that as a fourth potential.

Senator STEVENS. That would be a great problem. I have seen evidence of that in the past. You have a good point.

You could not possibly make the assumption that some of the truly disabled could, in fact, go on to the job market and have a cushion against inflation by a supplemental income.

I think that is the assumption we must make.

Mr. DEVINE. I am sympathetic to a great deal of this. I think what you have done is to make a very serious attempt to try to find a compromise position.

I think, however, the administration's bill is a superior way to approach a couple of very difficult problems.

The first is that if we are going to achieve the budgetary savings which the President desires, and which I think most of the Senate desires, part of that savings will come from the approximately one-half billion dollars to be saved through the President's revisions in the cost-of-living adjustments.

The difference between this figure and the Carter budget is $273 million. In other words, I think the saving here is a necessary part of the President's overall economic program.

Second, I do not think the bill answers the criticism that the retirement system is the only program which includes a twice-per-year cost-of-living increase.

I think that criticism will continue if this bill is passed just as it is. Eventually the increase would be reduced to once a year. You would end up with once a year at the high age and the middle age, but you would have the negative effect of having those at the youngest retirement age receive only half the benefits.

From one side you get the complaint that the cost of living should only be once a year, while the other side likes the current arrangement. I understand that many of those who are going to testify today are going to critique the bill from the latter perspective.

It seems to me one of the problems in seeking a compromise, which I think this bill represents, may be described, as an old professor of mine would say: "The middle of the road is not always the safest place. You can get hit on both sides."

I think that is an inherent problem with any serious attempt to come to grips with this issue. There are complaints from the public at large about the unfairness of granting to some retirees a twice-a-year increase, while giving others only half of the cost-of-living increase.

The administration's bill, I think, has equity on its side. It is once a year for everyone, the same as social security and other indexing programs. It saves money in the first year.

There is no question that your bill would save more money over the longer run. But if the President's program is to have full impact in this first year, I think we need that initial savings.

So, for these reasons I think you have some very interesting ideas. I think you have made a serious attempt to find a solution acceptable to everyone. No one can question your commitment to retirees, with your past record. It is an honest attempt.

I just think it really does not meet our immediate goal of saving money now, nor does it solve the equity problems on both sides—

the general public's perception of twice a year being too much, and the retirement and Government employee constituency's concern about the half rate for those in the earlier group.

It is a good attempt to arrive at a middle position. But after a close analysis—and I did look at it closely—I come down on the side of the administration's position for the reasons I have suggested.

Thank you.

I would ask that my formal testimony be inserted in the record.

Senator STEVENS. Without objection, your prepared statement will be inserted following your testimony.

There are problems. There is no question about that.

I have two questions.

First, when you look at the situation we are in of people in Government service being denied an adjustment for several years, that is, the full adjustment, and then they retire, are they not in a position a few years out, when they only get a once-a-year cost-of-living adjustment?

People who have retired before then who have gotten their full cost-of-living adjustments were not denied the raises that were necessary to beat inflation. They are going to be ahead of them in yours, are they not?

Mr. DEVINE. They will be ahead of them, yes. But I think the real problem is difficult for us here in Washington to see. When you get back home, you can see it.

The reaction of the average citizen would be not that those retiring now do not receive enough, but that the earlier retirees received too much.

I am not saying that is accurate, but that is the public perception. I think this is one of the reasons civil servants take a lot of unnecessary abuse from the citizenry.

There is a perception out there that there is an inequity and that the Government is rewarding itself disproportionately. The average taxpayer thinks the Government is running a con game. He or she reasons: "I only get a once-a-year increase. My grandmother gets the same. Why should Government retirees receive twice-a-year increases?"

My major academic field is public opinion. Maybe that is why I emphasize what people think and why they think it.

Senator STEVENS. When I run into that complaint and I look into it, I find it was a person who was in the military service who retired after a short period of time—20 years—a short-term retiree, who is working.

He is very much in contact with the whole community. He has a full-time job, but he is getting his retirement pay based upon 20 years, and it is being adjusted twice a year to inflation, although he is already working in the private sector and already getting cost-of-living adjustments on a full-time basis.

Those are the ones who are causing the problems. It is not the civil service retirees. In terms of my community that I visit, this is the case.

And yet we raised the military pay 12 percent last year. We are supposed to raise it 15.5 percent again this year. We are going to

continue to adjust them once a year, based upon 20 years service. Where is the equity on that compared with the civil service?

Mr. DEVINE. Again, that is a problem of perception. The factual situation is not always the basis for Government decisions. Public perception sometimes is the basis.

Senator STEVENS. They are the people who have more contact with the working private sector. It is not the civil service retiree at 55, 60, or 65 that is that much involved. Few of them get into full-time jobs. Most of them supplement their income by about 30 percent.

My studies show that the average is 30 percent as an addition to their retirement income. The military is more than 100 percent.

I think the problem is not in the civil service retiree. It is in the military retiree. I know it is in Alaska. That is their right. They have an entitlement under existing law.

I am not being critical of them. I am being critical of the system that refuses to give the civil service employee even a cost-of-living adustment, but insists that we are going to give two pay raises this year to military people which, when they retire, will really exacerbate this retirement picture in the future.

Senator Pryor?

Senator PRYOR. Thank you, Mr. Chairman.

Dr. Devine, Federal retirement benefits, unlike other Federal benefits, are taxable. Does the administration presently propose to change the tax status of these benefits?

Mr. DEVINE. No. We have not done anything on it yet. I have no settled views about that.

Senator PRYOR. Do you have tables or figures to indicate how much revenue the Federal Government generates by the taxation of the Federal benefits?

Mr. DEVINE. The overall revenue gain would be known only by the Department of the Treasury.

Senator PRYOR. The distinguished Senator from Alaska, the chairman of the subcommittee, has introduced S. 677. How many retirees and survivors are in each of the categories created under this legislation?

Mr. DEVINE. I do not have that information with me. I can supply it for the record.

Senator PRYOR. I would appreciate that very much.

Senator STEVENS. Without objection, so ordered.

[The material referred to follows:]

NUMBER OF RETIREES AND SURVIVORS IN CATEGORIES PROPOSED BY S. 677

[As of Sept. 30, 1980]

| | Over 65 | 60 to 65 | Under 60 |
|---|---|---|---|
| Nondisabled | 602,453 | 188,162 | 113,940 |
| Disabled | 343,153 | 81,393 | 141,301 |
| Survivors | 427,452 | 47,636 | 127,835 |

Senator PRYOR. Do you think the changes in the cost-of-living adjustments, through either S. 677 or the administration's proposal, will change civil service hiring or retention trends?

Mr. DEVINE. Of course we are in a period of reduced hiring. Obviously anytime you reduce benefits in a market system—and, of course, the Government competes in the market for employees—and anytime you decrease benefits, you are in a less favorable competitive situation.

Government would still be very competitive with private industry on this. The retirement age in the Government is 55 whereas in private industry it is more like 65.

Senator STEVENS. May I interrupt?

Senator PRYOR. Certainly.

Senator STEVENS. Would not the proposal I made encourage people to stay in the Government rather than leave?

Mr. DEVINE. Oh, yes. There is no question about that. As I mentioned in my testimony, I think that is one of the major factors in favor of it.

Senator STEVENS. Thank you.

Senator PRYOR. Dr. Devine, as you know, this committee has been very concerned about the delays—and we have expressed our concerns about delays in the processing of retirement claims. I was encouraged by your comments at the confirmation hearing about this unresolved issue, but I would like an update on developments in claim processing.

Mr. DEVINE. I have been looking at it very closely and giving Mr. Nelson a lot of trouble on it. I will let him respond to that.

Mr. NELSON. Thank you, Mr. Devine.

We have made a large amount of progress in our ability to produce retirement claims.

In the month of March we expect to issue over 20,000 claims, which is the highest number issued since I have been associated with the program. It is over twice our ability to issue claims that we had a year ago.

The backlog situation which reached nearly 100,000 cases last April was reduced to 65,000 cases in January. We had a large surge of retirements at the end of January. That has pushed that figure up some at this time.

Our experience is that large surges of retirements are followed by periods of lower than normal retirements. We are seeing those in our receipts right now.

Based on our projections of receipts and our current production levels, we expect that the backlog situation will be essentially eliminated by the end of this fiscal year. We will be down then to about 30,000 cases on hand, which is the normal amount of cases that we expect to have in normal processing and which keeps everyone occupied while we are adjudicating the claims and gathering evidence.

Senator PRYOR. But you think you are making progress?

Mr. NELSON. Yes, sir.

Senator PRYOR. Everytime OPM comes before us, they tell us they are making progress. I do not know if those retirees who are out there whose claims are stacked up feel like any progress is being made.

Mr. NELSON. Sometimes I do not know, either. There are several definite signs of progress. One is that the average time it takes now to issue an annuity case is about 90 days. It previously had been as

high as 140 days. That is already showing up in the speedier way we can handle cases.

The second thing is that we have continued to place emphasis on our special payments program. On the average, we put employees who retire into special payment status within 20 days after we receive the claim.

That average is about 86 percent of the actual amount. It is not the final adjudication, but it is money. We think money is the reason we are going through this process.

Senator PRYOR. Thank you.

Senator STEVENS. We appreciate your testimony, Dr. Devine. We are going to see if there is some middle ground.

I expect to hear both sides today before the day is over.

Mr. DEVINE. Thank you, Senator.

[Mr. Devine's prepared statement follows:]

PREPARED STATEMENT OF DONALD J. DEVINE

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to comment on S. 677, a bill "To amend chapter 83 of title 5, United States Code, to provide an equitable system of cost-of-living adjustments for civil service annuitants, and for other purposes."

S. 677 would change the current system of semi-annual adjustments of civil service annuities based on the Consumer Price Index. Like the Administration's proposal to shift to annual cost-of-living adjustments, S. 677 would serve to control the expense of these adjustments, but it would do so in a different way. Annuitants would suffer some financial loss under any proposal to restrict cost-of-living increases, but S. 677 would protect those over 65 from any change and instead shift the burden of these changes in the protection against inflation to younger annuitants. Under S. 677, those 65 and over would continue to receive full semi-annual increases. From age 60 to 65, annuitants would receive a single adjustment each year based on the full increase in the CPI, as under the Administration's proposal. Annuitants under age 60 would receive one adjustment each year equal to one half of the percentage rise in the CPI. Surviving spouses would be treated in the same way as retirees, with their adjustments depending on their age. Surviving children would all get full increases once a year.

As a consequence of the changes that S. 677 would make to cost-of-living adjustments, the bill would have an interesting side effect. If annuitants under age 60 were to receive only limited adjustments for inflation, we believe there would be a significant incentive for employees to delay their retirement until they reached age 60. In order to avoid the serious loss of purchasing power that would result if there were high inflation, a large number of employees could be expected to work longer than they do now and this would reduce the overall cost of the retirement system as well as help retain older, more experienced employees in the Federal service.

For those employees who do choose to retire at age 55, S. 677 would actually reduce their protection against inflation. On the other hand, S. 677 would fully protect those retirees over 60 against inflation. There is an element of irony here: a preliminary investigation by our Actuary suggests that current annuitants who have been retired for 10 years, most of whom would be in the over 65 group, have actually fared better than more recent retirees. In comparing increases in annuities with increases in Federal pay, we have found that the annuities of individuals who were on the retirement rolls by the early seventies have increased as much as 35 percent more than Federal pay. This means that these older retirees are receiving substantially higher benefits than would be paid to employees retiring today from the same positions and with the same length of service.

As an example of the problem and of how S. 677 would work, consider the following: An employee who retired in 1971 at the top of the pay scale for GS–9, with 30 years of service and at age 55, would have received an initial annuity of $563 a month. Today, with cost-of-living adjustments over the last 10 years, that annuity would be worth $1355 a month. By contrast, a similar employee retiring today would receive an annuity of only $1067 a month, nearly $300 a month less than the earlier retiree is now receiving. Under S. 677, that earlier retiree, who would be 65 now, would continue to receive full, semi-annual cost-of-living adjustments, but the new retiree, with an identical career, would receive only one half of

CPI increases for the first five years. As a result, five years from now the difference between their annuities would be even greater: $1192 a month for today's retiree and $1859 for the 1971 retiree, a difference of $667 a month or 64 percent. The operation of cost-of-living adjustments has already given a large advantage to those retired for some time as compared with those still working, and S. 677 would have the unfortunate effect of increasing this advantage.

As written, S. 677 would apply to disability annuitants in the same way it applies to all other annuitants, with the percentage and frequency of cost-of-living adjustments based on the disability annuitant's age. We understand that it was the intent of the bill, however, to preserve full, semi-annual adjustments for all disability annuitants, regardless of age. If the bill were to be revised to do this, we must point out that there would be significant problems resulting from a large increase in the number of employees seeking and perhaps qualifying for disability retirement. Such a premiun for disability retirement might disrupt our efforts to get the disability program under control.

While we are sympathetic to the intent of S. 677 to protect the oldest annuitants from any reduction in cost-of-living adjustments, we must oppose the bill, and urge that the Administration's proposal for annual cost-of-living increases for all civil service annuitants be enacted instead. The Administration's proposal would produce greater savings in the initial years than S. 677, $510 million as compared to $273 million in fiscal year 1982, for instance.

The semi-annual adjustments provided civil service annuitants by current law will, in our view, continue to draw critical attacks if they are not changed for all annuitants to provide conformity with virtually every other Federal benefit program that adjusts for inflation. This is the basis for the Administration's proposal, and the reason we remain committed to that proposal as the best solution to the expense of civil service cost-of-living adjustments. Both civil service annuitants and Social Security recipients need and depend on the full indexation of their retirement benefits. Any limit on cost-of-living increases, such as granting only 50 percent of the increases in the early years of retirement, as S. 677 would do, would cause a decline in the purchasing power of the annuitant's benefits. We believe that the beneficiaries of Federal programs should be assured that their benefits will remain constant in real terms.

We believe, therefore, that the Administration's proposal for annual adjustments for all annuitants is a better approach than S. 677 to the problem of the unacceptable expense of cost-of-living adjustments for civil service retirees. It would continue to fully protect all annuitants from inflation. It would produce greater savings in the initial years than S. 677, and would contribute significantly to the President's Program for Economic Recovery.

For these reasons, we cannot endorse S. 677 but recommend instead that the Administration's proposal for annual adjustments be enacted.

I will be happy to answer any questions you may have.

Senator STEVENS. Our next witness is Clifford Gould, Director, Federal Personnel and Compensation Division, General Accounting Office.

Mr. Gould?

## TESTIMONY OF CLIFFORD I. GOULD, DIRECTOR, FEDERAL PERSONNEL AND COMPENSATION DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY ROBERT SHELTON, DEPUTY ASSOCIATE DIRECTOR

Mr. GOULD. Good morning, Mr. Chairman.

I would like to introduce Mr. Robert Shelton, who is the Deputy Associate Director for Civilian Personnel in the Federal Personnel and Compensation Division.

I am pleased to be here today to discuss S. 677, the proposed Civil Service Retirement Cost-of-Living Adjustment Act of 1981.

Under present law, all civil service annuities are adjusted semiannually by the full percentage increase in the Consumer Price Index, or CPI. The proposed act would make several changes in this policy.

Under the bill, retirees and survivors age 65 and over would continue to receive full, semiannual adjustments. However, retirees and survivors under age 65 would receive adjustments only once a year.

The annuities of retirees and of surviving spouses between the ages of 60 and 64 and all surviving children's annuities would be adjusted once a year in an amount equal to the full percentage increase in the CPI.

The annuities of retirees and of surviving spouses under age 60 would also be adjusted once a year, but in an amount equal to one-half the percentage increase in the CPI.

The General Accounting Office has long been concerned about the equity and costs of the Government's policy of full, semiannual cost-of-living increases for Federal civilian and military retirees.

This policy is far more generous than the adjustment provisions found in most private industry and State and local government pension programs. The increases received by Federal retirees have also been greater than pay increases granted Federal workers.

We have recommended that adjustments be granted once a year and that consideration be given to limiting the adjustment to something less than the full CPI increase.

In the interest of brevity, I will not present here the findings which led us to conclude that the adjustment process should be revised.

I would like to request, however, that a copy of our latest report—B–130150, July 1, 1980—containing our detailed findings on the subject be included in the record.

Senator STEVENS. We would be happy to have your comments. We do not need the whole report.

[Comments from GAO report B–130150, July 1, 1980, follow:]

Private pensions have not kept pace with inflation the way Federal retirement programs and social security have. A 1975 study of corporate pension plans by the Bankers Trust Company revealed that only 6 percent of the plans provided automatic cost-of-living adjustments; most plans limited the adjustment to 3 percent annually. Similarly, a 1977 survey by Hay Associates revealed that only 7 percent of the pension plans had automatic adjustments; most plans had a specified limitation. The Congressional Budget Office reported in 1978 that only 3 percent of private pension plans have explicit cost-of-living adjustment features.

Most State and local plans offer some sort of post-retirement cost-of-living adjustments, but those adjustments rarely represent the full percentage increase in the CPI. The President's Commission on Pension Policy found that one-half of State and local pensions are adjusted for inflation with a 3-percent cap.

Social security benefits are the principal source of retirement income for non-Federal retirees. All retirees of private industry and most retirees of State and local governments receive social security; this is the only source of retirement income for many retirees. But most retirees of State and local governments and approximately 50 percent of all private industry retirees also receive an employer-provided pension. Social security serves as the base level of benefits. The employers' plans generally are designed to supplement social security and guarantee retirees a specified level of total retirement income—typically 50 percent to 70 percent of their preretirement level of earnings. Although the social security component is fully indexed, the supplemental pension generally is only partially indexed. Consequently, the retirement income of most non-Federal retirees is not fully protected from inflation.

The full, automatic cost-of-living increases in Federal retirees' benefits have greatly exceeded the pay increases granted to active Federal civilian employees and military personnel. This is illogical, highly inequitable, and encourages valuable, experienced Federal employees to retire rather than to continue working. This problem has been particularly acute for top Federal officials who have received smaller and less frequent pay increases than other Federal personnel.

Compared with the 114 percent increase in Federal civil service retirees' annuities since 1970, top Federal officials' pay rates (Executive Level V) have increased only 39 percent; 33 percent since 1977. Thus, the pay increases received by top Federal officials (GS–16 through GS–18 and Executive Level V) have been considerably less than those received by regular civil service employees and former Federal employees and officials who chose to retire rather than to continue working.

A new policy of limiting annual annuity cost-of-living increases to the average percentage pay increase granted to active Federal employees would be more logical, more equitable, and less costly. It also would help encourage retirement-eligible employees to remain in the active work force and result in annuity increases that are more consistent with those received by most non-Federal retirees who receive both social security and a supplemental private or State/local goverment pension.

Full, automatic annuity cost-of-living adjustments are costly. With outlays for Federal civilian and military retirement approaching $30 billion annually, a 1-percent annuity cost-of-living adjustment increases retirement outlays by about $300 million. The last two adjustments—March 1, 1980, and September 1, 1979—of 6.0 percent and 6.9 percent, respectively, resulted in outlay increases of at least $3 billion. Given the magnitude of retirement outlays and the double-digit inflation we are experiencing, limiting the adjustments could reduce current and future retirement outlays substantially.

Mr. GOULD. The proposed legislation addresses concerns we have had with the adjustment process and would reduce the retirement system's costs considerably.

However, there are several observations and comments we would like to offer for your consideration in the deliberation on this bill.

It is our understanding, based on the chairman's comments when introducing the bill, that it is an alternative to the administration's proposal for annual cost-of-living adjustments.

As the chairman indicated, fiscal year 1982 savings under S. 677 would be less than the estimated $510 million savings from annualized adjustments.

But in the long run, retirement outlay reductions would be much greater under S. 677 than once-a-year increases.

I might point out that those reductions would be reduced annuities to Federal employees—that is, taking money out of the retirees' pocket, which is a little bit different than your statement of support for Federal retirees.

Senator STEVENS. Where is that?

Mr. GOULD. The fact that you are going to reduce annuities more in the long run, in effect, takes money out of the pockets of the retirees.

Senator STEVENS. The increment, if you analyze it, comes from the fact that you are dealing with early retirees, the 20-year people, who would not get their second adjustment until they reached retirement age.

I wish you people would analyze some of these things before you make comments like that. You and I are going to go around and around. That is not so.

I do believe that retirement age people should receive full treatment and equitable treatment. The problem about this is that the early retiree gets a twice-a-year cost-of-living adjustment and on his military pay also.

Ours puts in the military impact and in the out years it is very great. But in the short run it is not touching the retiree of retirement age at all.

Mr. GOULD. As I complete my statement, I think I will cover some of those points.

Senator STEVENS. Please proceed.

Mr. GOULD. The Office of Personnel Management estimated fiscal year 1982 savings of $273 million based on the S. 677 proposed changes excluding any changes to disability retirees and surviving spouses.

By fiscal year 1984, the savings would increase to $514 million, which exceeds the estimated savings of $388 million from annual adjustments for that year. The amount of savings would continue to grow substantially each year thereafter.

It should be recognized that the savings from S. 677 would initially come from a relatively small group of retirees. Seventy-five percent of the retirees on the rolls at September 30, 1980, would not be affected by the changes. About 60 percent of the survivors are also unaffected.

The civil service retirees who would receive only 50 percent of the CPI increases would bear the burden of inflation more than retirees in other programs while other civil service retirees would get far more.

In general, non-Federal retirees are covered by social security, which provides for full, once-a-year inflation adjustments. In addition, most State and local government retirees and about 50 percent of all private industry retirees also receive employer-provided pensions which are partially indexed. We estimated that 70 to 80 percent of the typical non-Federal retirees' total pension—including social security—is indexed to inflation.

When introducing the bill, the chairman indicated his intention to retain full, semiannual annuity adjustments for disability retirees. While we can appreciate the chairman's concerns, it should be pointed out that continuing to provide such adjustments for civil service disability retirees would be inconsistent with the recently enacted annual adjustment process for Federal employees with job-related disabilities—workers' compensation—and with the process applicable to non-Federal employees who are receiving social security disability benefits.

Also, continuing to provide full, semiannual adjustments to civil service disability retirees would create a substantial economic incentive for employees under age 65 who are eligible for optional retirement to seek disability retirement. This would increase the disability retirement caseload, could be subject to potential abuse, and might necessitate further legislative changes in the disability retirement eligibility criteria.

Another concern we have is that the bill applies only to the civil service retirement system. However, if enacted, it would apply by law and Executive order to other civilian retirement systems. Military retirees, who typically retire in their early- to mid-forties, would continue to receive full inflation protection.

Senator STEVENS. What do you mean by that?

Mr. GOULD. The authorization bill that was passed last year provides that if the civil service retirement system is adjusted to once-a-year annuities, the military adjustment process would also be changed.

It does not provide for any other changes other than a once-a-year adjustment. Our attorneys have told us that if this particular bill is passed, there would have to be a reauthorization of that for the military retirement system.

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Senator STEVENS. I do not believe that is true. This will be the new law for both.

It is the full intent; if not, it will be, I assure you, if it is passed.

Mr. GOULD. The point we are making is that we think the authorization bill has to be changed, the military authorization.

Senator STEVENS. We are amending the military authorization bill in this bill itself.

Mr. GOULD. In this bill?

Senator STEVENS. It is intended to do so.

Mr. GOULD. What I am suggesting is that the language ought to make that clear. We believe the problem is this. It is the military who are able to retire at such a young age that is causing most of the concerns.

Senator STEVENS. As I said before, that is the difference between your calculations and ours. It does apply. We intend it to apply.

Mr. GOULD. While further study may be needed to assess the impact of applying similar changes to the military retirement system, we believe that limiting such a major policy change only to civilian retirees is inappropriate.

In view of the above, we believe that full, once-a-year adjustments to all Federal retirement programs would be preferable because:

One, all retirees and survivors would be treated equally.

Two, the adjustment provisions would be consistent with both the Federal workers' compensation and social security programs.

Three, the provisions would be more consistent with prevailing non-Federal practices.

In addition, I would like to suggest that the committee consider another change to the cost-of-living adjustment provisions which would clarify how increases should be applied to annuities payable from the fund for those retirees who elect survivor benefit coverage.

We addressed this matter in our recent report entitled, "Changes Needed in Calculation of Reductions in Civil Service Annuities for Survivor Benefits"—FPCD-81-35, February 26, 1981.

Currently, the law does not specify whether cost-of-living adjustments are to be applied to reduced annuities or unreduced annuities. The Office of Personnel Management has elected to apply the increases to the reduced annuities.

Because of a mathematical anomaly, this results in a higher cost to the Government and creates monetary inequities between prior and new retirees. New retirees always pay more than earlier retirees for the same survivor coverage.

We believe it would be more equitable to recalculate the annuity reduction each time there is a cost-of-living adjustment. This would insure that past and future retirees pay the same amount for the same survivor benefits.

The change would also result in a savings to the Government of at least $76.8 million annually. We have recommended that OPM make this change administratively. However, they told us it would be better to clarify the law.

We have suggested language to make this change and I would ask that it be placed in the record at this point.

Senator STEVENS. Without objection, so ordered.

[The information referred to follows:]

*Be it enacted by the Senate and House of Representatives in Congress assembled,* That section 8340 of title 5, United States Code, is amended by adding at the end thereof the following new subsection:

"(g) In applying the percentage increases authorized under subsection (b) of this section to an annuity reduced under sections 8339 (j) or (k) of this title, the percentage increase shall be applied to the full unreduced annuity and then the annuity shall be reduced as provided in sections 8339 (j) or (k) of this title."

SEC. 2. Section 8339(j) of title 5, United States Code, is amended by striking out the last sentence thereof and, in its place adding the sentence "Such reduction shall be effective the first day of the first month beginning 1 year after the date of remarriage."

SEC. 3. The amendments made by this Act shall apply to the first increase under section 8340(b) of title 5, United States Code, that occurs not less than 90 days after the enactment of this Act, and shall apply to all annuities subject to reduction under sections 8339 (j) or (k) of title 5, United States Code, except that the amendments made by this Act shall not cause a decrease in the amount of any annuity being paid on or before such first increase.

Mr. GOULD. This concludes my statement, Mr. Chairman. We would be pleased to answer any questions you may have.

Senator STEVENS. I do not understand the GAO position with regard to the annuitant under 60. As a matter of fact, I do not understand people retiring under 60. So, you can see my prejudice in the matter.

The failure to recognize the fact that people retire, that is, some of them retire in their forties, and why we should attempt to deal with them as though they are retired people in the sense of age, I do not understand this.

Why do you not look at the age of the retiree and look at the statistics of how they affect the statistics in terms of this problem?

Mr. GOULD. Mr. Chairman, for some time we have asked, or rather, have suggested that the Congress take a comprehensive look at retirement in the Federal Government and to come up with some overall policies on what it is that the retirement annuities are expected to accomplish.

What is a reasonable retirement age for a retirement system? What percentage of income is expected to be protected after an individual retires? At what level of income should their retirement benefits be maintained compared with their pay?

There are any number of committees on the Hill that have jurisdiction over various retirement systems. The changes are made piecemeal. When you go back to try to find out why they were made, it is very difficult to find the rationale for most of the changes.

I would agree with you. Retirement needs to be looked at in that sense. The Congress needs to give all of the people a feeling as to what it is in terms of retirement they can expect.

Senator STEVENS. How about the statistic that 75 percent of all senior executives retire at the earliest age possible? Did you know that?

Mr. GOULD. Yes, sir; I knew that. I have testified on the compression problem on any number of occasions. What your bill would do would be to say:

You are capped. We are not going to give you an adjustment so you can retire. You are going to stay in the Government and you are going to be capped. Or else you are going to retire without an adjustment and go to work someplace else.

Senator STEVENS. I have tried to do something about the cap. I cannot do anything about that, but I think I can give them the incentive for staying in the Government.

Mr. GOULD. It is a negative incentive, however.

Senator STEVENS. You are going to give them a worse incentive. You are going to give them a once-a-year cost-of-living adjustment rather than two.

Mr. GOULD. I do not see how once a year is more severe than a half of an adjustment once a year.

Senator STEVENS. By definition, it will. My bill, once you make 60, we have the same adjustment in my bill as you recommend.

Mr. GOULD. I would agree that once a year is more negative than twice a year.

But I think you would also have to agree that half of an adjustment once a year is more negative than a full adjustment once a year.

Senator STEVENS. Senator Pryor?

Senator PRYOR. Thank you, Mr. Chairman.

I have no questions, Mr. Gould, but I may want to submit questions in writing.

I would ask that the record be kept open for that.

Senator STEVENS. Without objection, so ordered.

Thank you very much, Mr. Gould.

We next will hear from Michael Nave of the National Association of Retired Federal Employees.

Mr. Nave?

**TESTIMONY OF MICHAEL C. NAVE, PRESIDENT, NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES, ACCOMPANIED BY JUDITH E. PARK, LEGISLATIVE DIRECTOR, AND STEVE SKARDON, LEGISLATIVE ASSISTANT**

Mr. NAVE. Thank you, Mr. Chairman.

I am accompanied this morning by Judith Park, our legislative director, and Steve Skardon, our legislative representative.

In keeping with your request to make our remarks as brief as possible——

Senator STEVENS. I do not think we ought to beat a dead horse. It does not look like it has gone very far. [Laughter.]

Mr. NAVE. I very much agree with your concluding remarks about the red flag. That propaganda machine has been trying to murder us for the past 2 years. Over and over again I am reminded of that famous Quaker saying: "Round is round, even if everybody is for it. Right is right, even if everybody is against it."

Mr. Chairman, I am pleased to appear this morning before this important subcommittee with you at the helm, and Federal supporters like Senator Mathias and Senator Pryor serving with you.

I am forced to admit that I am basically quite frustrated in having to once again come before you to justify and support continuation of the civil service retirement benefit that all of us know is fair and equitable. That is, the semiannual cost-of-living adjustment.

In 1979 and again in 1980, the Carter administration proposed annualizing this adjustment. Both times we argued against any reduction in the current semiannual benefit. Two years in a row,

with the assistance of friends like you, Senators Mathias and Pryor, and supporters in the House, we won the battle to maintain the just benefit.

By everyone's admission, this does not overcompensate Federal retirees and survivors in helping them maintain the purchasing power of the retirement annuities. Those twice-a-year adjustments are so vital to the people in the lower annuity brackets in order to keep them closer to the soaring cost of inflation.

Just 6 months ago President Reagan was telling Federal retirees that the twice-a-year indexing of their annuities was a proper method to protect retirees from the destruction of the value of their benefit payments. He said: "I do not favor abandoning the present semiannual indexing."

His position at that time was entirely consistent with the position of the House of Representatives which, only a month earlier, had rejected Mr. Carter's proposal for an annual COLA by a 309-to-72 margin.

But as we know in February, President Reagan himself proposed annualizing the COLA, citing the semiannual adjustment as clearly unfair. I have yet to find out why. If it was deemed proper last fall, why by winter was it clearly unfair?

There are many in the administration and Congress who rushed to advise us that the Federal retirement programs are the only entitlement programs adjusted more than once a year. Yet, I have heard no one point out that the Federal retirement programs are the only ones that are taxed. They talk about equity one way. Would they give us equity the other in relieving us of income taxes?

I am frustrated by these many contradictions. I am frustrated and angered by times in which the value of a legislative proposal changes. Is that good government, Senator?

Last Sunday, in a Washington Post interview, the President expressed the view that this association has long held.

The real culprit is inflation. If inflation can be brought under control, then the issue of COLA is moot.

He also said: "The measure of living costs should be more selective to actually fit the needs of people to which adjustments are applied."

Yet, we hear this morning to forget what the cost of the CPI says. Let us make this adjustment on another basis. What is the use of having a yardstick?

I recently testified before Congressman Paul Simon's budget committee task force in favor of doing just what the President suggests.

What makes all this so confusing is that the President appears to be sensitive to the needs of the older persons, the truly needy. But his budget recommendations take a different tack.

Mr. Chairman, we realize that you continue to believe that the semiannual adjustment is fair and equitable and that the bill you introduced, S. 677, is, in fact, an alternative to what the President is asking Congress to approve. We commend you for the courage to submit an alternative. We only regret that we cannot support your proposals for the following reasons.

One, S. 677 violates the most fundamental principle of a staff retirement system in which benefits are keyed directly to earnings and service.

Two, it defers the Government's commitment to its employees and retirees to maintain the full purchasing power of Federal annuity by providing full indexing only to older retirees.

Three, it imposes financial hardships on persons forced by law to retire at an early age in the name of effective government by halving their retirement benefits in the name of Government savings.

Four, it has a devastating effect on those in the lowest income groups, survivor annuitants, between the ages of 22 and 60. There are 79,905 individuals in this category, primarily widows of workers who died in service, and mothers of the 57,541 child survivors.

The average annuity of this group is $305 per month. To limit these people to once-a-year cost-of-living increase of 50 percent of the CPI would punish the lowest income groups, and eliminate a major financial benefit their employees' spouses had been assured for the financial stability of their families in the event of an untimely death.

Mr. Chairman, you and your committee may be interested to know that we submitted a proposal to the then new budget director that could produce substantial savings to the Government in its management of the unfunded liability in the civil service retirement fund.

Any of the several approaches could prove far more helpful than the COLA cutbacks proposal could. There has been no reply to our letter of January 13, 1981, and apparently no action is being contemplated in this respect.

The President has voiced concern and has refrained from proposing any changes in the basic retirement benefits and in the indexing of those under social security.

We know you are concerned about those with low incomes under civil service retirements, especially in times of high inflation when it is admitted that social security should also receive a semiannual adjustment.

Very little is talked about that at this time. The Advisory Council on Social Security, composed of prominent businessmen and civic leaders, has recommended that the social security be also given twice a year, or semiannual, adjustments to more nearly keep them abreast of the cost of living. They need it just as badly as some of our people do.

I, too, am concerned. Civil service annuitants are also justified in opposing changes in their basic retirement benefits and indexing mechanisms.

There is a limit to what Congress can do before it disrupts programs and promises which are vital to the effective Government employment and credibility.

A reduction in the semiannual COLA, in our humble estimation, exceeds that limit.

Thank you for this opportunity of appearing before you. I would be glad to answer any questions.

I would ask that my prepared statement be inserted in the record.

Senator STEVENS. Thank you.

Without objection, your prepared statement will be placed in the record following your testimony.

You are right. This proposed impact on survivors has not been properly analyzed.

Mr. NAVE. That is true.

Senator STEVENS. We intended to change that so the age of the survivor would not be the determining factor. You are correct there.

Senator Pryor?

Senator PRYOR. Thank you, Mr. Chairman.

Mr. Nave, you made reference to a letter, I believe, that you sent to OMB making some suggested changes.

I do not know that I have seen that letter. It might be appropriate and helpful if we had that letter.

Mr. NAVE. I would say very much so. The letter is addressed to Don Moran, who was Associate Director of OMB, with the understanding that it would receive his attention.

This is nothing new. What happened here, in 1977 after the actuarial reports of the Civil Service Commission were released, was that the Office of Management and Budget suggested and recommended that an outside group of experts in this field be brought in. The Commission did that. They brought in experts from the Wharton School of Commerce of the University of Pennsylvania.

They made recommendations. The report of the private sector consultants—Park R. Davidson, Burlington Industries; Dan McGill of the University of Pennsylvania; and Mark Twinney of the Ford Motor Co.—was submitted to the Civil Service Commission on April 15, 1977.

There were a number of suggestions on financing. In other words, what they were driving at was the management of this unfunded liability and the amount of tax money that the public is required to pay to sustain it.

In 1979 this amounted to $4.8 billion. For heaven's sake, let us put a brake on it. We agree with you wholeheartedly. Put a brake on it. Freeze it. Stop it. Revise it. Amend it. Anything to reduce the impact on the taxpayer and at the same time do justice to the retirees. You can effect a more tremendous savings in the management of this one than you can by eliminating the COLA. Take a look at it.

Senator PRYOR. With the Chairman's permission, I would like to have a copy of that letter placed in the record.

Mr. NAVE. We will be glad to furnish a copy of this. In fact, it is quite a voluminous document.

Senator PRYOR. Let's not put the whole thing in there. Let us see how large it is first.

Senator STEVENS. I think we would like to have a copy of the letter.

Mr. NAVE. Certainly.

Senator STEVENS. Without objection, so ordered.

[The letter (with attachments) referred to follows:]

JACK GOLDBERG
VICE PRESIDENT

GEORGE E. AUMAN
DIRECTOR OF FIELD OPERATIONS

L. J. ANDOLSEK
SECRETARY

MONROE W. WILLIAMSON
TREASURER

NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES
1533 New Hampshire Ave., N.W., Washington, D.C. 20036 Area Code (202) 234-0832

MICHAEL C. NAVE
PRESIDENT

January 13, 1981

Mr. Don Moran
U. S. House of Representatives
Longworth Building, Room 1502
Washington, D. C. 20515

Dear Mr. Moran:

Following is a brief summary and several supporting documents of the budget matter we talked about on the telephone Monday, January 12th.

Pursuant to a 1976 directive from the Office of Management and Budget, private sector consultants were engaged to advise the Civil Service Commission on financing of the Civil Service Retirement Fund.

Report of the private sector consultants, Park R. Davidson, Burlington Industries, Inc., Dan M. McGill, University of Pennsylvania, and Marc M. Twinney, Ford Motor Company, was submitted to the Civil Service Commission on April 15, 1977.

On the assumption that these studies will be made available to you, only pertinent excerpts from them regarding their conclusions revealing the trend of their thinking, and several other interesting items, are shown in the attachments. One of them is an analysis of the studies made by Andrew E. Ruddock, former Director of the Bureau of Retirement, Insurance & Occupational Health on the same subject. His recommendations are attached. All this data deserves serious consideration at this time.

Of increasing concern to Federal Retirees is the upsurge in old arguments being used and new horror stories being served up to the media in a renewed effort to influence the public, Congress, and officials in high Administration positions to solve the Government's money problems by reducing benefits to retirees. In consequence we became the 'symbolic' target of the Carter Administration as a gesture to restrain spending. We have learned from experience that distortions by the press have influenced public sentiment against our retirement system which Congress, upon careful study, time and time again has found capable of meeting its obligations and remaining fiscally sounder than any other government retirement plan and most, if not all, private plans.

The approach laid down in Public Law 91-93 for funding the system was a major step toward the current fiscal integrity of the Fund. However, because of the continued wild inflation since 1969, that no one could anticipate, and

in the light of current economic conditions, it may not be amiss to evaluate the current effectiveness of this law, and recommendations made to lessen the impact to the government of growing interest payments. Consideration in this respect should also be given to the growing feeling among actuaries and economists that a public retirement fund need not be fully funded. These advocates contend that these are 'systems in perpetuity,' backed by faith in the U. S. Government.

As one of the attachments shows, instead of these interest payments adding to the balance, they add to the government's cost. We believe the situation is well worth carefully reviewing at this time. We feel it would vastly assist President Reagan and his Administration and Republican Party in keeping the promises made before the election not to erode benefits of retirees at a time of sustained high inflation rates, when they need every cent of their income. I am confident he wants to keep this promise and retain the good will and confidence of the retirees that helped elect him because of his consideration for their economic wellbeing. To that end, Mr. Stockman can count on our full cooperation and assistance.

Sincerely,

Michael C. Nave
President

Attachments

CC to Congressman Derwinski with encls.

MCN:kp
File
Reading file

# Reagan & Bush

Reagan Bush Committee
901 South Highland Street, Arlington, Virginia 22204 (703) 685-3400

October 3, 1980

Governor Reagan today issued this statement to the National Association of Retired Federal Employees:

"Over the three and a half years of the Carter Administration, the Consumer Price Index has increased by 43%, a rate in excess of 10% a year. Under these circumstances, the benefits of all retired persons are seriously threatened unless inflation adjustments are made in a timely fashion.

"The present civil service retirement law properly provides for a cost of living adjustment to protect retirees from the destruction of the value of their benefit payments. The adjustment is made semi-annually .

"In an era of sustained high inflation rates, it is not reasonable to expect retired federal civil servants to absorb a 10% decline in the purchasing power of their benefit checks before an adjustment is made to reflect the higher cost of living.

"I do not favor abandoning the present semi-annual indexing.

"In the long run, however, inflation must be brought under control. The economic health of our society is at stake, and the policies of a Reagan Administration will be designed to preserve that health by restoring sound money and reasonable expectations.

"I have also declined to endorse the idea of forced Social Security coverage for federal employees. I am well aware that instituting such coverage could result in a reduction of retirement benefits that federal employees have a right to expect.

"As for the universal coverage proposals, I will study the report of the National Commission on Social Security and other reports when they are presented before making any final decision."

FUNDING COSTS OF CSRS

2. The NC, additional payments resulting from the UAL, and interest earned by trust fund assets all become costs for purposes of evaluating the most efficient method of financing a system where trust fund assets are not invested with an independent third party but are invested in the securities of the employer, as is the case with CSRS. This is because a sponsor who invests the system assets in its own securities must pay the interest on such assets in addition to the direct sponsor contribution to the system. Because CSRS is artificially restricted from outside investments, as a matter of national policy, however, interest payments are not a valid cost for comparison with costs of other plans not so restricted. It is also not a valid cost for purposes of comparing the value of benefits provided federal employees in the private sector.

Once this unique characteristic of the federal government being both a contributor to CSRS and the provider of the investment return on the CSRS assets is recognized, it becomes a major consideration in selecting the most efficient method of financing CSRS. Unlike private plans where the higher contribution level associated with conservative funding leads to ever growing plan assets and those assets in turn provide an ever growing source of additional revenue, the reverse is true with regard to CSRS. For CSRS, higher contribution levels will lead to a higher level of asset accumulation and this in turn will add a requirement for even greater federal government interest payment to CSRS in addition to the NC.

Summary of Recommendations*

1. If no other change is made, modify the system to require 30 year amortization of liability created by cost-of-living annuity increases.
2. Adopt the current trend of private and public retirement systems that actuarial cost estimates should include assumptions of continuing inflation and make plans to prefund such costs.
3. Accept the private sector advisors proposed "Forecast Actuarial Cost Method" and the six criteria that go with it.
4. Adopt a goal of meeting termination of plan liability in 40 years.
5. Continue employee contributions at 7% of payroll.
6. Require agencies to contribute, out of their appropriations, the balance of dynamic normal cost not met by employee contributions.
7. Continue the present 30 year amortization schedules and require 30 year amortization of any liability, using dynamic assumptions, newly created by liberalizing amendments.
8. Appropriate to the CSR Fund the total amount of estimated unfunded liability.
9. If 8 above is not acceptable, amend the law to include 40 year funding of termination of plan liability in the permanent indefinite transfers of interest on the public debt. Reject any proposal to substitute discretionary annual appropriations for the present automatic transfers.
10. Discontinue transfers of funds to cover benefits for military service.

The consultants evaluated the actuarial analyses carried out by the BRIOH staff and Dr. Winklevoss and Mr. Allison against a set of six postulated criteria of an acceptable financing approach:

(1) All actuarial cost and liability calculations must reflect realistic economic assumptions, meaning that the salary scale and interest assumption should reflect expectations as to inflation and real wage gains.

(2) Cost-of-living adjustments to benefit payments should be funded and all cost projections should reflect the anticipated annual growth in the Consumer Price Index, which serves as the basis of the COL adjustments.

(3) The annual cost of the System to the federal government, as a percentage of payroll, should be reasonably stable.

(4) The normal cost of the System should be ascertainable and publicized with a view toward revealing the proportions of cost borne by the covered employees and the government.

(5) The funded ratio (the ratio of assets to some appropriate measure of accrued liability) should never decline and as a minimum the assets within a reasonably short period of time should equal the actuarial liability for benefits to retired employees and other beneficiaries ; and

(6) The assets of the System should never exceed some upper limit, such as the termination-of-plan liability.

If these criteria can be satisfied, the benefit expectations of the participants and their beneficiaries should be realized and the cost of the System will be equitably apportioned among different generations of taxpayers. Moreover, and equally important, the determination and publicizing of the true long-run cost of the System should help to keep benefit levels within reasonable bounds.

Mr. NAVE. We want to get to the root of this thing. All of this flag waving is about the amount of interest that is going into the unfunded liability. We know there is a better way.

We have a number of economists that more recently have advocated the fact that a fund for Government employees need not be fully funded for the simple reason that it is a Government perpetuity. If you cannot have faith in the Government to back it up, then what do we have?

To give you an illustration, we have a reserve in the civil service retirement fund of four or five times what the annual outgo is. Take a look at what you have under social security. It still is a Government-sponsored plan but does not have more than 6 months reserve.

Let us get things in balance and get the funds in balance. You will not have to have some of these poor people who need the money desperately every time they get it.

Senator STEVENS. I have suggested that to Mr. Stockman.

Mr. NAVE. I would suggest that perhaps Mr. Stockman is doing a tremendous job in highlighting these things. But then he ought to leave it to the good judgment of Congress and his peers to determine whether or not they should be adopted.

Mr. PRYOR. Mr. Nave, you talked about $305 a month being the average benefit for survivors.

Do you have any figures to show or demonstrate that this is the average income for these people? Do we have something along those lines to back that up?

Mr. NAVE. All we have are the official figures put out by the Office of Personnel Management.

In this regard we find some very interesting documents eminating from the Congressional Budget Office, as late as February 1981, dealing with the financing.

We have highlighted the fact that we have so many fat cats here that are getting away with murder under civil service. Yet, the Congressional Budget Office has come up with a very interesting figure.

They made an analysis of the social security returns. They are recommending taxes. They find that people with income between $20,000 and $30,000 constitute 3.8 percent of the total; $30,000 to $50,000, 2.3 percent; $50,000 to $100,000, 0.7 percent; and $100,000 and over, one-tenth of 1 percent.

Yet, by golly, under the civil service we only have 1.1 percent above the $30,000. So, whose ox is being gored?

Senator PRYOR. I do not know what is wrong with the system. Evidently, there is something wrong with it or Senator Stevens and I would not be constantly wrestling with trying to come up with a better system.

But we have some problems here. I think one of the problems is communication. I know that you do a great job and your organization does a great job.

I noticed the AARP and the NRTA have come out in support of some of the things you have stated. But I find that a large number of people do not make the distinction between a social security recipient and a Federal annuitant.

They do not realize that social security is not taxable and that the Federal retirement benefits are taxable. Somehow or another we are missing that cog. We are not getting that message out to people. I am not saying that even if we got that message out, that would solve the dilemma. There is a perception of inequity here. As Dr. Devine testified, we deal with perceptions. I think this is one of our major hurdles.

I am not saying I am supportive of the chairman's bill. I know his sincere interest to do something about the system. Every year we fight this battle again.

I know that everytime we do that, each and every retiree out there feels the shock waves and panic waves that go through the retirement community. They do not know what to expect next. It makes them uneasy. I want you to know we are trying to find some answers.

Mr. NAVE. I could not agree with you more. We do not have the resources and the money available to us that the U.S. Chamber of Commerce and the National Association of Manufacturers and others have in exploiting this.

But not one of them has ever mentioned equity and income taxes. No one has ever explained how you are going to help all these other people by taking something away from us.

Again, I want to say that I have nothing but tremendous admiration for Senator Stevens' proposal. It is a signal to us that at least one leader in Congress does not agree with his own President.

Thank you very much.

Senator PRYOR. I would like to say this. Last year and the year before had he not been fighting on the front lines, in the trenches, and the foxholes, I think we would have seen some very bad things happen to many, many retirees.

He was on the front line. I know he is attempting once again to try to explore some answers.

Mr. NAVE. And we appreciate his support. You have played a tremendous role in this, also, Senator. I want to tell you that the retirees of this country appreciate it more than I could ever say in my own humble language.

Thank you.

Senator STEVENS. Thank you very much, Mr. Nave.

Mr. SKARDON. Senator Pryor, we do have that table you were asking about regarding the age breakdown and the average annuity for each age group if we could submit that for the record.

Mr. NAVE. Yes, we would like to have that in the record.

Senator STEVENS. Without objection, so ordered.

[The table referred to and Mr. Nave's prepared statement follow:]

TABLE B-11.—NUMBER OF EMPLOYEE ANNUITANTS AND SURVIVOR ANNUITANTS ON THE RETIREMENT ROLL AS OF SEPT. 30, 1979, BY AGE

| Age | Nondisability | | Disability | | Survivors | |
|---|---|---|---|---|---|---|
| | Number | Average monthly annuity | Number | Average monthly annuity | Number | Average monthly annuity |
| Under 19 | | | | | 43,207 | $160 |
| 19 to 22 | | | | | 14,334 | 166 |

## TABLE B–11.—NUMBER OF EMPLOYEE ANNUITANTS AND SURVIVOR ANNUITANTS ON THE RETIREMENT ROLL AS OF SEPT. 30, 1979, BY AGE—Continued

| Age | Nondisability | | Disability | | Survivors | |
|---|---|---|---|---|---|---|
| | Number | Average monthly annuity | Number | Average monthly annuity | Number | Average monthly annuity |
| 23 to 29 | | | 342 | $436 | 1,880 | 189 |
| 30 to 34 | | | 2,537 | 494 | 1,988 | 242 |
| 35 to 39 | | | 4,350 | 538 | 2,743 | 291 |
| 40 to 44 | 16 | $746 | 7,552 | 560 | 4,743 | 322 |
| 45 to 49 | 1,066 | 783 | 16,731 | 584 | 9,496 | 341 |
| 50 to 54 | 12,832 | 993 | 37,688 | 633 | 21,357 | 362 |
| 55 to 59 | 95,517 | 1,078 | 76,199 | 701 | 37,698 | 389 |
| 60 to 64 | 174,409 | 1,009 | 75,484 | 688 | 46,363 | 402 |
| 65 to 69 | 199,353 | 870 | 54,234 | 617 | 54,586 | 400 |
| 70 to 74 | 163,968 | 807 | 28,977 | 565 | 56,738 | 384 |
| 75 to 79 | 100,764 | 718 | 14,402 | 476 | 56,757 | 348 |
| 80 to 84 | 68,376 | 636 | 10,016 | 417 | 43,777 | 326 |
| 85 to 89 | 31,263 | 553 | 3,950 | 357 | 22,265 | 297 |
| 90 to 94 | 7,870 | 506 | 676 | 325 | 7,584 | 263 |
| 95 to 99 | 1,189 | 500 | 79 | 357 | 1,561 | 227 |
| 100 and over | 89 | 490 | 13 | 399 | 242 | 222 |
| Total | 856,712 | 859 | 333,230 | 629 | 427,319 | 336 |
| 62 and over | 688,403 | 807 | 155,195 | 589 | 272,135 | 361 |
| 65 and over | 572,872 | 774 | 112,347 | 557 | 243,510 | 356 |

Source: "Federal Fringe Benefit Facts 1979," Office of Personnel Management.

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STATEMENT OF MICHAEL C. NAVE, PRESIDENT
NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES (NARFE)
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE, AND GENERAL SERVICES
U. S. SENATE
ON S. 677

APRIL 1, 1981

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Mr. Chairman, I am Michael C. Nave, President of the National Association of Retired Federal Employees. For nearly 60 years, our Association has represented the interests of retired Federal employees, their spouses, and survivors. We have a dues-paying membership of 425,000 representing the concerns of 1.5 million Federal annuitants. In the past year, our membership has increased by nearly 60,000 -- a figure I believe is indicative of a growing concern among Federal retirees throughout the country about the future of our Nation's retirement policies.

Mr. Chairman, normally I would say that it is a pleasure to appear before this Subcommittee to share with you the concerns of Federal retirees about legislation affecting their future. However, this time, I must tell you that I am finding it most frustrating to have to appear before this and other committees of Congress year after year to defend the legitimacy of the semi-annual cost-of-living adjustment. While it is certainly appropriate for this Subcommittee to conduct timely oversight of automatic indexing, it is difficult for our membership not to view the reappearance of this issue -- for the third consecutive year -- as deliberate harrassment.

Mr. Chairman, I want you to know that our Association is very grateful for the excellent leadership and support you and Senators Mathias and Pryor have provided all retirees on issues which have so directly affected the elderly. We realize that you continue to believe the semi-annual COLA to be both fair and equitable. When



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President Reagan challenged members of Congress to propose alternatives to his budget reductions with which they had disagreements, you made an extensive effort to find some reasonable alternative. We commend you for this effort.

There can be little doubt that the commitment of this Administration and many of the leaders of this Congress is to squeeze every possible dollar of savings from the Federal Government's domestic programs regardless of the long-range consequences. These are times in which the value of a piece of legislation is not based on merit or long-range impact, but on the immediate savings it will produce. Those with clout in Washington are no longer persons with knowledge and expertise of Federal systems, but those whose computers tell us how much money we can save. I realize I am out-of-step with this Administration and the Senate Budget Committee since I believe spending reductions should only occur in a manner which will not jeopardize the effectiveness or vitality of sound programs. Those of us who advocate thoughtful, responsible spending reductions are clearly outnumbered by those who would cut now, and figure out the consequences later.

There is no better example of this than the issue of the semi-annual COLA.

Only six months ago, the man who is now President was traveling across the country telling Federal retirees that he believed the twice-a-year indexing of their earned annuities was an appropriate manner "to protect retirees from the destruction of the value of their benefit payments." He told them flatly, "I do not favor abandoning the present semi-annual indexing." This was entirely consistent with the action of the House of Representatives, when only one month before it resoundingly rejected Mr. Carter's annual COLA proposal by a 309-72 margin. I am sure you recall that representatives of the GAO testified before this Subcommittee less than two years ago to say that "the indexation of Federal retirement programs and benefit programs is fully justifiable on the grounds of equity." Last year's

Social Security Advisory Council even went so far as to suggest that the single COLA adjustment now received by Social Security recipients should be upgraded to a semi-annual formula. Mr. Chairman, I noticed that even as you introduced S. 677, you reaffirmed your belief that the semi-annual COLA is fair and responsible. Is it not a dismal commentary on this Congress that we meet today to discuss options for undermining a Government program we all believe to be fully justifiable in its present state?

Mr. Chairman, as I mentioned, our Association commends you for looking for alternatives to the President's proposed once-a-year COLA. As I understand your bill, you propose continuation of automatic COLA increases for all annuitants except that you would vary the size and frequency of these increases depending on the age of the annuitant. Persons under 60 would receive an annual adjustment equal to one-half the rise in the Consumer Price Index, while those between 60 and 65 would receive similar annual increases equal to the full CPI rise for that year. Retirees on disability and those over age 65 would continue under the present semi-annual formula.

Our Association has taken a close look at the possible impact of this legislation. Unfortunately, we cannot support the changes you have put forward. Not only does this legislation violate the most fundamental principles of a staff retirement system, but in thousands of cases, it will actually impose individual hardships far greater than those affected by the Reagan plan.

Mr. Chairman, as you well remember, when the semi-annual COLA was first established, members of Congress stated flatly that their decision to implement such an adjustment represented a clear and simple commitment to retirees on which they could rely for their future financial security. Senator Hollings, one of the principal authors of the current formula, testified to that effect before this Subcommittee only two years ago. The basic issue raised by your legislation is the integrity of the United States Government in living up to this commitment to maintain the full purchasing power of Federal annuities. This commitment is the key to employee confidence

in this system. Any violation of this commitment would, in our view, constitute the first step in the disintegration of the integrity of this system which has served so well for the past 61 years.

Furthermore, this legislation, if enacted, would establish a dangerous precedent permitting future Congresses to freely tamper with retirement benefits to fund pet projects or simply satisfy public demands for lower Federal spending. The legislative history of the Federal retirement system is one which holds sacred promises made by the Government to its employees. This legislation would represent a major turning point in that legislative history.

However, the most alarming part of your legislation for our membership is the impact it will have on the individual retiree. As you are aware, the average Federal annuity is slightly more than $10,000, while the average survivor annuity is approaching $4,800 a year. Because all of this income is taxable, studies have shown that the twice-a-year indexation of these benefits roughly enables recipients to maintain the full purchasing power of this income.

The passage of S. 677 -- because it reduces this indexing formula -- would be a clear policy change in that it would guarantee that the annuity of any person who retired before age 65 would consistently lose purchasing power every year until the recipient's 65th birthday. This would impose hardship on persons forced to retire by law before they reach this age. This group includes firefighters, law enforcement personnel, military retirees, foreign service personnel, and air traffic controllers. The standard response of our critics is that these people are retiring at age 55 and taking on other jobs to earn additional income from Social Security or other pensions. However, the fact is that most of these people have a very difficult time

learning new skills which can be readily applied to other jobs, and generally are forced to depend on these annuities as the mainstay of their livelihood. They are required to retire at early ages in the name of effective Government service. Now it is proposed that they take reduced retirement benefits in the name of Government savings.

However, the most devastating aspect of S. 677 would be the impact it would have on those receiving survivor annuities -- specifically those between the ages of 22 and 60. These people are overwhelmingly female spouses of workers who died in service. As you are aware, they become entitled to a survivorship annuity equal to 55 percent of that to which the worker was entitled. There are 79,905 individuals in this category. Our information shows that they are primarily widows and the mothers of 57,541 child survivors. Their average annuity is $305 a month. For Congress to limit this group of survivors to COLA increases of 50 percent of the CPI would be a cruel and heartless act. The effect of S. 677 would be to punish the lowest income group in the Federal retirement system, while eliminating a major financial benefit their employee spouses had been promised to insure the future security of their families in the event of untimely death. In the case of these individuals, the formula you have proposed would uncontrollably dissipate the substantive value they receive from their survivor benefits.

Mr. Chairman, before closing my remarks I want to add a word of caution to those Members of Congress who believe that reductions in retirement benefits -- like cost-of-living adjustments -- in both Federal retirement and Social Security are necessary to hold down inflation. We retirees have heard that logic before -- and we are still waiting for some results.

The call for an annual COLA continues a trend that began in 1976. In a continuous pattern of seeking budget savings by reducing Federal retirement benefits, Congress has:

a) Repealed the 1 percent adjustment that made up for the time lag, (1976).

b) Taken the Sick Pay Exclusion of the Tax Code away from most disabled Federal retirees, (1976).

c) Eliminated the Retirement Income Credit, replacing it with a Tax Credit for the Elderly, which ironically works to the detriment of elderly retirees over age 65, (1976).

d) Singled out public retirees for punitive treatment in the survivor/spouse offset provision of the Social Security Act, (1977).

e) Repealed the "look-back" feature that gave retiring workers partial credit for annuity adjustments he passed up in order to stay on the job and complete an assignment, (1980).

When does this stop? Inflation continues to rage.

Mr. Chairman, I am bound by my Association's mandate to support the present semi-annual COLA formula. However, I must tell you that even without that mandate, there are no circumstances under which I, or any of our national officials, could support this legislation. It presents a frightening prospect for the future, while undermining the confidence we have held for so long in our Federal retirement system for ourselves and our families.

Our membership is not insensitive to public concerns over irresponsible Federal spending. We share these concerns, and support efforts to make Government more cost efficient. However, there is a limit to what Congress can do before it disrupts programs and promises which are vital to effective Government employment and credibility. A reduction of the semi-annual COLA reaches that limit.

Senator STEVENS. Our next witness in George Hennrikus of The Retired Officers Association.

Colonel Hennrikus?

## TESTIMONY OF COL. GEORGE F. HENNRIKUS, JR., CHIEF LEGISLATIVE COUNSEL, THE RETIRED OFFICERS ASSOCIATION

Colonel HENNRIKUS. Thank you, Mr. Chairman.

I am Col. George F. Hennrikus, Jr., U.S. Air Force, retired, chief legislative counsel of The Retired Officers Association, TROA, which has its national headquarters at 201 North Washington Street, Alexandria, Va.

Our association has a membership of over 293,000 retired, former, and active duty officers of the seven uniformed services. Included in our membership are 35,000 widows of former members. On this occasion I am also pleased to represent the Retired Enlisted Association of Colorado Springs, Colo.

Our principle concern with S. 677 is in its possible application to the uniformed services. Legislative history demonstrates that modifications to the civil service system are frequently applied to the uniformed services, more often than not as an accommodation.

For example, with respect to this matter before the subcommittee, the Armed Services Committee is prepared to honor its decision made in the last Congress to defer to the recommendation of the Governmental Affairs Committee if that recommendation is to reduce to an annual pay adjustment which fully reflects the Consumer Price Index.

My purpose here is to oppose replacement of the current formula with that outlined in S. 677, under any circumstances, but more specifically, to demonstrate why its application to the uniformed services would be counterproductive.

I first would like to turn to the military retirement system. Beyond the pay source itself, there is very little commonality between civil and uniformed service careers. The uniformed services retirement system is unique.

It is a personnel management tool used to select the right people for the career force and to eliminate those not needed. Most military retirees are forced out by an "up or out" system known as selective retention. Of every 100 who enter service, only 10 attain minimum retirement, or 20 years' service, and only 5 complete 30 or more years. As a consequence, according to the latest Department of Defense statistics, the average age of retirement in the uniformed services is 41 for enlisted and 46 for officers.

For the most part, only general or flag-rank officers are able to remain on active duty beyond 30 years and almost all of these are retired prior to age 55.

By the way, there are currently about 4,131 general and flag-ranks retired. There are almost as many E-7's—technical sergeants, chief petty officers—retired as the total number of officer retirees.

Those who attain retirement receive from 33 percent to 64 percent of their active duty compensation and enjoy continuing medical care and the use of the base exchange, commissary and other military facilities. Retired pay and entitlements are considered by service personnel to be deferred pay earned during active duty.

All but a very few must leave service at their families' most expensive point. They must then enter a new career in which they have little hope of advancement over others who have been in the field for their entire working lives. Laws restrict, by forfeiture of pay or criminal sanction, employment in civil service or in positions in the private sector which deal in defense matters.

Annual retirement pay for officers averages $13,000; for enlisted, who make up two-thirds of the retired force, it is $8,500—hardly enough for even a marginal standard of living. This system is not a charitable act on the part of the Government. Retirees are subject to recall to active duty at any time and to the Uniformed Code of Military Justice.

The principle of involuntary recall was reinforced as recently as December 12, 1980, when the Defense Officer Personnel Management Act became Public Law 96-513.

Paragraph 688(a) states:

> Under regulations prescribed by the Secretary of Defense, a retired member of the Regular Army, Regular Navy, Regular Air Force, or Regular Marine Corps may be ordered to active duty by the Secretary of the military department concerned at any time.
>
> The Secretary concerned may, to the extent consistent with other provisions of law, assign a member ordered to active duty under this section to such duties as the Secretary considers necessary in the interests of national defense.

In an effort to measure the effect of S. 677 on a typical retiree, I computed the impact on an E-7 with 24 years' service, who retired in 1964 at age 44. Under the current formula he receives $739 per month. Under S. 677 he would now be receiving $404 per month, or 45 percent less. This is illustrated on a chart which I would ask be inserted in the record.

Senator STEVENS. Without objection, so ordered.

[The chart referred to follows:]

EFFECT OF S. 677

*E-7—24 years service—retired October 1964—at age 44*

| | *Per month* |
|---|---|
| Initial rate of retired pay, 1964 | $246 |
| COL increases under present system (1964-80) | 492 |
| Actual current pay (age 60) | 738 |
| Under S. 677 proposal: | |
| Initial retired pay | 246 |
| COL adjustments would have approximated (1964-80) | 158 |
| Estimated current pay (age 60) | 404 |

Colonel HENNRIKUS. I have not addressed the problem of implementing S. 677. Its administration, including its application to Survivor Benefit Plan annuitants, would appear to be complex.

If such a system was applied to uniformed services retirees, there would be one positive effect. That is that those over 65 deserve favored status. The system under which this older group served prescribed pay adjustments in concert with those applied to the active force.

This system was suspended in 1958 and repealed in 1963. No savings clause was incorporated in the change. In the late 1960's

and early 1970's, the active force received increases designed to achieve comparability with the civilian sector.

As a consequence, for many years the older group received 30 percent to 40 percent less pay than they had been led to believe they could expect. With the realization that recovery of the losses they sustained during those years was not feasible, my organization has supported for many years—and continues to support—legislation which would provide a one-time adjustment to current pay scales for post-65 retirees.

I have one final comment. The service chiefs have all agreed that the single greatest problem they face is the exodus of middle grade managers—senior non-commissioned officers and junior officers.

It is my observation that the principle reason for this exodus is frustration with the low quality recruits with whom they must deal. However, adaptation of a system such as that outlined in S. 677 can only increase this exodus.

Hopefully, we all share the view that a war-winning capability, the only true deterrent to war, must be developed and maintained on a priority basis. Dedicated, responsive people make up the most significant element of this capability.

Therefore, we ask that you consider the possible impact of S. 677 on people in uniform.

Thank you.

Senator STEVENS. I do not want to seem antagonistic because I am also chairman of another committee. I certainly am not. I think your organization ought to start thinking about what you are going to do when the proposal is made that military people contribute to their own retirement.

What you are saying, really, is that people who do not contribute to their own retirement who are, in fact, people who average in their forties, are the ones who are going to be hurt most by this proposal.

They are going to be hurt a lot more by the concept that they, too, should contribute to their retirement.

Colonel HENNRIKUS. I think that might be welcome to the troops if they received the whole package and the pay was raised accordingly.

Senator STEVENS. It has been.

Colonel HENNRIKUS. And they received a 40-hour week, overtime pay, and equal travel pay between stations—10 times the amount they now receive and we are allowed to choose our place of assignment.

If you want to relate it directly to the civil service system, then maybe that would be welcome among a number of people. It would not be welcome among our leaders and strategic planners because that is not the way you run a military force. They would equate it to reaping the whirlwind.

Senator STEVENS. I think some of those things will have to be studied.

Colonel HENNRIKUS. They certainly are. They have been studied in 10 major studies in the last 5 years. No one has come up with a solution as yet.

By the way, Mr. Chairman, I certainly appreciate your support. You probably have the greatest sensitivity to a military career of anyone in the Senate that I know of, offhand.

Your remarks this morning, notwithstanding, I am sure you understand——

Senator STEVENS. I am not against the increases to the military. I am just pointing out that those people who support them are also the people who normally oppose the civil service increases. I do not understand it.

Colonel HENNRIKUS. Those people who support what, sir?

Senator STEVENS. Who support the military increases most fervently are normally the ones who oppose the civil service increases.

Colonel HENNRIKUS. I do not know of whom you speak.

Senator STEVENS. I just know them; that is all.

Colonel HENNRIKUS. You will find no one in our organization in that particular position. We do not compete with the civil service. We are a separate service completely.

Our main concern is to find the best people and put them in uniform and make it possible for them to stay in uniform for their greatest potential time.

Senator STEVENS. For a while we saw a flow from military from uniform people in DOD to civilian. We all saw that. People came out of uniform, but remaining——

Colonel HENNRIKUS. There were 150,000; yes, sir.

Senator STEVENS. I think in the coming years you are going to see it go back the other way. Before June we will have passed a 27.5 percent increase for military people. In the same period we have 4.8 percent income for civilians.

Colonel HENNRIKUS. If this is so, perhaps we could turn over recruiting offices in all major cities to civil service and civil service could assume the costs.

Senator STEVENS. It means we are going to have a flow from civil service to military. There is no question about that.

Colonel HENNRIKUS. That would be great if we could do that. I think that would be fantastic. We need that kind of people in the service.

We do not have them now. I have a son-in-law at Fort Riley. He is losing his best NCO's, his best junior officers out of frustration with the quality of people they have to deal with. This is nothing against the Army. It is an indictment of the educational system of this country. Something has to be done. We are not attracting the right people.

Senator STEVENS. Being a father of five children, I would agree with you on that.

Senator Pryor.

Senator PRYOR. I have no questions, Mr. Chairman.

Senator STEVENS. Thank you very much.

Our next witness is John Cosgrove from the Fund for Assuring an Independent Retirement.

Mr. Cosgrove?

## TESTIMONY OF JOHN E. COSGROVE, CHAIRMAN, FUND FOR ASSURING AN INDEPENDENT RETIREMENT

Mr. COSGROVE. Thank you, Mr. Chairman.

Senator Stevens and Senator Pryor, I appreciate the opportunity to appear before this committee on behalf of the Fund for Assuring an Independent Retirement.

This is one of the newer organizations that have appeared here. With your permission I would like to say a word about it.

This is a coalition of 26 national organizations representing millions of Federal, State and local postal employees and retirees who are concerned with a range of issues affecting their members now or in the immediate future.

These include the resistance to mandatory coverage of all such employees under social security and our objection to discriminatory offsets which single out public employees unfairly.

The third major objective is the maintenance of the social compact which the American people, through Congress, have with Federal employees to protect them from the erosion of their annuities by inflation—the rate of which, as you know, is currently annualized at 12.1 percent.

I would like to refer, if I could, to the first witness this morning, Dr. Devine's reference on several occasions to the perception of the Federal annuitant and his status.

To some degree this is a self-created scapegoat or strawman to which they are contributing. It is precisely because some political leaders and candidates have chosen to allege that the Federal employees have undue benefits and inequitable benefits that the problem has arisen.

I think it is more in the eye than in the fact.

I would also like to say that we are fully conscious and greatly appreciative of the leadership of you, Senator Stevens, and Senator Pryor and others of this committee—but particularly you two gentlemen—for the appreciation you have of the public interest as it applies to Federal and postal employees.

This has been very helpful over the years. We look forward to continuation of this sort of leadership.

Of course much of the premise for many of the unfortunate proposals arising today is the assumption that the social security trust fund cannot sustain the demands against it.

Sylvia Porter has commented on this. It generally reflects the views of many of us that, in fact, between the trust funds there could be some borrowing that would be helpful.

The alternative there would be the possibility of—or perhaps it could be done conjunctively—the use of the general revenue. This should not be overlooked.

This is not the prime purpose of this hearing today, so I will speak no more about that. I think the important premise on which this bill rests is subject to some serious question.

The additional point must be made that the basically progressive Federal income tax as a source of revenue would, in our judgment, be more equitable generally for the people of the United States as a financing mechanism than would the regressive tax system that is inherent in FICA.

The background, of course, for the issue that you are discussing is one that really involves a long series of on-again, off-again policies by the Government of changing its policies over the years

trying to arrive at something that is equitable. We think it has been arrived at at this point.

The proposed reductions in the COLA, we do not think will save money. Unlike the social security benefits of the civil service annuities, these are taxable at every level.

The Advisory Council on Social Security recommended that social security benefits be adjusted twice a year and the civil service annuities be adjusted annually.

President Reagan and some of the media have urged that the CSRS is overly generous. This overlooks the fact that these employees contributed 7 percent out of their entire salaries and wages. When ranked with company pensions, in many instances, the private sector retirees have higher total benefits than those under the civil service retirement system, even aside from the element of taxation.

The trail of broken promises is clear. In 1976 Congress repealed the add-on. The same year there was the elimination of most disabled civil service retirees the disability tax exclusion. In 1977, there was a limit on retirement income credit. In 1978, public employee spouses were singled out in the spouse-offset amendment act. In 1980, Congress repealed the look-back feature which gave retiring workers partial credit for an inflation adjustment that occurred while he or she was working. In 1981, President Reagan reversed his position of 1980 and asked Congress to change the cost-of-living adjustment.

To exacerbate the situation, the President has asked for authority to cap white collar worker pay at 4.8 percent, whereas the 1970 comparability law would provide an increase of more then 13 percent between 1969 and 1980.

Predecessors have similarly capped Federal pay to an aggregate over that period of 88.86 percent while private sector pay climbed 109.7 percent and the cost of living increased 127 percent. Each cap, of course, lowers the possibility, or the annuity to be received. So it is a very serious problem.

Peculiar problems, of course, are with the foreign service which depends on an up and out system. This is the result of a reduction in the voluntary retirement. In that case there would be an equal rise in the number of mandatory separations. People selected out, as a result, would receive only the generally curtailed annuity. Unlike the civil service they cannot participate in a lower grade.

In net, then, we must oppose S. 677, with all due respect. We think it would be particularly hard on those who have to retire early. In any case, setting 65 as a precondition to a semiannual COLA would be unjust to thousands of Federal employees, just as cutting it in half or by some other percentage for the adjustment for those over 60.

We think Government productivity is increasing. We hope to help it increase. We think the inequity to current employees and retirements, and in the public interest, the present COLA adjustment should not be attacked by Congress.

I would ask that our formal presentation be inserted in the record. Thank you.

Senator STEVENS. Thank you.

Without objection, your statement will be inserted following your testimony.

There is a lot of history and truth in what you say, Mr. Cosgrove.

Senator Pryor?

Senator PRYOR. Thank you, Mr. Chairman.

May I ask one question?

You just stated that $1.5 billion was paid by the Federal retirees in income tax.

Mr. COSGROVE. The Federal retirees income tax——

Senator PRYOR. It appears on page 5 of your prepared testimony at the bottom of the page in the last paragraph.

You state: "Of approximately $15 billion paid to civil service retirees in 1980, $1.5 billion was returned to the Federal Treasury as income taxes——"

Mr. COSGROVE. That is correct.

Senator PRYOR. [continuing] "And an additional $898.6 million was paid in State-local taxes."

How much would be saved if we went to the once-a-year, or stayed with the once-a-year cost of living adjustment?

Mr. COSGROVE. I do not have the figure. It progressively would increase over the years very substantially.

As you would be aware, it is a savings from the point of view of cutting the budget, if one assumes that is the overriding requirement. It is a loss from the point of view of the equity to the retiree if one assumes that is the objective to be sought.

Senator PRYOR. I am just wondering what would happen if we just waived the income tax to the Federal annuitant.

Mr. COSGROVE. There certainly would be a consistency in that, at least, in terms of the social security recipients.

But, in our judgment, the present situation is satisfactory. It clearly is a lag. At no time is the Federal annuitant, even with the twice annual COLA, at the present formula, vis-a-vis the CPI, that is, at no time is the lag made up. It was not even probable when the 1 percent kicker was permitted. But at least there is the possibility of their catching up.

I think this very graphically illustrates the point that this is not, as alleged in some quarters, the cause of inflation. It indeed follows on as the caboose. It is not the locomotive.

Senator PRYOR. So your contention, Mr. Cosgrove, is that they are paying more income tax on the amount earned than we would save if we go to the once-a-year cost-of-living increase?

Mr. COSGROVE. I would think that would be true, but more relevantly in terms of the principle, this is—as was pointed out by one of the earlier witnesses—not to be confused with the social security system as it often is, whether inadvertently or intentionally.

But, it is an employee-employer retirement system, essentially, whereas the social security system is part of this social floor below which we do not want people to go. The principle is illustrated by the distinction. I think the maintenance of the present system is the only equitable way to proceed. I do not think it is a decisive thing in balancing the budget or halting inflation in any case. It

evidently is the result of inflation. The dollar increases, which admittedly have occurred, certainly are not the cause of inflation.

Senator PRYOR. Thank you, sir, very much.

Senator STEVENS. Thank you very much, Mr. Cosgrove.

[Mr. Cosgrove's prepared statement follows:]

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TESTIMONY
TO THE
SUBCOMMITTEE ON CIVIL SERVICE AND GENERAL SERVICE
COMMITTEE ON GOVERNMENT AFFAIRS
UNITED STATES SENATE
BY
FUND FOR ASSURING AN INDEPENDENT RETIREMENT

APRIL 1, 1981

The Fund for Assuring an Independent Retirement (FAIR) is composed of twenty six national organizations which has a total membership of several millions. These members work at every level of American government, well over one million of them in the Federal General Schedule or wage grade categories or in the U.S. Postal Service. We appreciate this opportunity to present this testimony on their behalf. I am John E. Cosgrove, Chairman, Board of Directors of FAIR.

FAIR is concerned with the range of issues that effect public employees and annuitants and, for present purposes, specifically federal/postal employees and annuitants. These include our resistance to mandatory coverage of all employees under Social Security and our objection to discriminatory offsets which single out public employees unfairly. Today our comments are being addressed to a third major objective of FAIR, the maintenance of the social compact which the American people, through Congress, has made with federal employees to protect them from the erosion of their annuities by inflation -- the rate of which, as you know, is currently, annualized, 12.1%.

The premise from which many unfortunate proposals arise, in this regard, is the assumption the Trust Fund cannot long sustain the demands to be made against it. However, as Sylvia Porter pointed out in her column of Thursday, March 26, 1981, there is ". . . no basis for anyone to panic over the short-term financing problems the Social Security system faces between now and 1985 . . . ." While it is true that that has risen in dollar amounts, due to the general inflation of the price structure and the lagging economy with smaller payrolls and less overtime, that is not the whole story. In FY 1980, combined disbursements for retirement, survivors and disability benefits (and hospital insurance payments under Medicare) will reportedly total $172 billion. Income from Social Security taxes in the same period are estimated to be $170 billion. The three Social Security Trust Funds have a $39 billion reserve, but the problem is that these reserves are chiefly in the Disability and Hospital Trust Funds. We suggest that Congress should vote to use those funds for payment of retirement and survivors benefits, thus ending any near term problem. This is really a cash flow problem that is faced by the OASI Trust Fund which will be met between the end of 1981 and the tax increase schedule for 1985. Thus borrowing among the Funds would make sense. If this is not sufficient, the borrowing could be supplemented by limited transfers of general revenues, a provision that should now be in the Social Security Act.

The longer term stories about the "bankruptcy" of Social Security are largely speculation and, if appropriate for legislation of any drastic sort, should still be considered only after demonstration of compelling need, lack of reasonable alternatives and after the most deliberate and thorough analysis.

Our purpose, however, is not to add to the multiplicity of suggestions Congress is receiving on the real or imagined problems of the Social Security system, since other labor, consumer and retiree groups can competently and equally address these questions. Suffice to point out that use of the general revenues is use of money raised by a basically progressive federal income tax as distinguished from the FICA tax which is regressive and on which the higher income people pay on only a fraction of their annual income.

Our chief concern here today is protecting annuities from inflation. FAIR has studied the matter, and the results of its study are presented below.

1. Background.

Present law requires that federal civil service annuities (and military retired pay) be adjusted twice a year to maintain the buying power of the original annuity. This legal entitlement should be honored.

For many years, adjustments were made on an ad hoc basis. Then, in 1962, adjustments were made automatic and linked to the annual averages of the "Consumer Price Index." The rate of inflation was so low for the next three years that no increases were triggered under the formula contained in the 1962 law.

In [illegible]ber 1965, Congress revised the cost-of-living adjustment formula based on the Consumer Price Index. If the CPI increased by 3 percent over the base, and held at that level or higher for 3 consecutive months, the highest level reached in the holding period would

determine the size of the adjustment which would go into effect three months after the end of the holding period.

In October 1969, Congress authorized a 1 percent add-on to each adjustment, to compensate for the time lag between CPI increase and actual annuity adjustment. The 1 percent add-on was abolished in 1976 on the questionable premise that it was "over-compensating" retirees, and Congress adopted the present formula which provides that annuities will be adjusted twice a year in the exact percentage amount of the increase in the CPI.

Soon after the Congressional budgeting procedures were overhauled, the Budget Committees of both Houses began to advocate a change to an annual cycle in the belief that considerable reduction in expenditures would result from lengthening the cycle between outlays. President Carter endorsed the idea.

The General Accounting Office supported annual adjustments, but also recommended that each increase be limited to something less than the increase in the CPI -- possibly 75 percent of the CPI increase or the same percentage amount as the preceding white collar pay raise.

The issue came to a vote in 1980, and a proposed change to an annual cycle was soundly defeated in the House, by a vote of 309 to 72.

Presidential candidate Ronald Reagan stated on October 3, 1980: "I do not favor abandoning the present semi-annual indexing." Once in office, however, he reversed his earlier position and in his economic message submitted to Congress on February 18, 1981, recommended annual adjustments beginning in fiscal year 1982. The Senate Budget Committee agreed in March 1981 (which is the status now).

2. The Issues in Perspective

The principal arguments used by proponents for changing to an annual cycle are given below, followed in each instance by FAIR findings which demonstrate the arguments to be without merit.

Argument

It is argued that by changing to annual adjustments, the government would save big money. The estimates of perceived savings vary according to who is talking, but generally it comes to somewhere between $400 million and $500 million per year for civil service retirees and more when military retirees are added.

FAIR Findings

-- Semi-annual adjustments do not over-compensate civil service retirees to a greater degree than the increase in the CPI. This finding has been confirmed even by an official of the General Accounting Office testifying to Congress. In other words, the adjustment formula itself washes out any element of compounding.

-- Congressional repeal of the "look back" feature in 1980, in response to budgetary pressures, slashed more money from annuity benefits than would a change from semi-annual to annual adjustments. In other words, a greater budgetary savings has already been achieved.

-- Unlike Social Security, civil service annuities are taxable at every level of government. Of approximately $15 billion paid to civil service retirees in 1980, $1.5 billion was returned to the federal treasury as income taxes and an additional $898.6 million was paid in state-local

taxes. In other words, civil service retirees are already returning much more to government than would be "saved" by a change in the adjustment cycle.

Argument

It is claimed that equity requires that civil service retirement adjustments be placed on the same annual cycle as Social Security adjustments

FAIR Findings

-- If the purpose of inflation adjustments is to protect the buying power of the original annuity, then the more frequent the adjustment the more valid the procedure.

-- Even with semi-annual adjustments, civil service annuitants have lost ground to inflation. With each adjustment, the tax liability grows progressively larger.

-- One of the most painful aspects of inflation to the older person is the time he or she must wait to obtain relief from prices that have already gone up. Recognizing this truth, the Advisory Council on Social Security recommended that Social Security benefits be adjusted twice a year -- not that civil service annuities be adjusted annually.

Argument

President Reagan, and a number of editorial writers who share this view, perceive that civil service retirement is overly "generous."

FAIR Findings

-- Civil service retirees receive good retirement because they buy and pay for good retirement by contributing 7 percent of their entire salary.

-- A FAIR actuarial study revealed that when Social Security benefits are linked with company pension plan benefits, in many instances the combination produces an income replacement that is higher than civil service retirement. When the element of taxation is introduced, the disparity becomes even more pronounced.

Trail of Broken Promises

Since the arguments for annual adjustments do not stand up under close examination, there must be other reasons for the persistent attacks. These reasons are budgetary and political, but it strikes at the very integrity of the government when lawful promises that have been made to its employees are not honored.

Recent history shows a trail of broken promises, and a clear pattern of punitive actions against public service retirees:

-- 1976. Congress repealed the add-on which compensated for time lag between inflation and relief from inflation.

-- 1976. Congress took away from most disabled civil service retirees the disability tax exclusion.

-- 1977. Congress limited the retirement income credit, to the detriment of older retirees.

-- 1978. Congress penalized public employee spouses, and them alone, in the spouse-offset amendment to the Social Security law.

-- 1980. Congress repealed the look-back feature that gave a retiring worker partial credit for an inflation adjustment that took place while he continued working, often in the interest of completing a valuable project.

-- 1981. President Reagan reversed the position he took in 1980 and asked Congress to change the cost-of-living adjustment cycle from semi-annual to annual.

The above trend assumes even deeper meaning when one considers that President Reagan has recommended the denial of a pay raise for federal executives whose pay has been frozen so long that five levels of senior employees are now receiving the same rate of pay.

Concurrently, the President is asking for authority to "cap" rank and file white collar worker pay at 4.8 percent while the 1970 comparability law calls fo. an increase of more than 13 percent between 1969 and 1980. Pay caps imposed by his predecessors have held federal employee pay increases to an aggregate of 88.6 percent while private sector pay climbed 109.7 percent and the cost of living increased more than 127 percent.

Each pay raise restrained by a "cap" results in a smaller annuity for the person retiring, and regardless of the interval between inflation adjustments, the loss is never recovered because at best the adjustments do no more than protect the buying power of the original annuity.

With all due respect, S.677 would work <u>particular</u> havor on people who, through no fault of their own, have to retire early.

However, even aside from this, the bill setting age 65 as an immutable precondition to twice yearly COLAs would work an inequity on thousands of federal employees. Similarly, to cut in half the adjustment based on the rate of inflation for those over 60 is arbitrary and, we think, wrong.

As seen above, we do not accept the proposition that there is injustice in the government continuing the compact it has with its workers on this question. The typical government worker now retires before age 60 -- and for such independents the retrogression to a single annual raise, equal to one half the CPI -- until age 60 and then only one complete or full COLA until 65 denies the role the federal government should play as an employer.

As just one example, the Postmaster General's annual financial report for FY 1980 indicates the postal service productivity increase of 5¼ percent for that year. We believe and hope that there are similar productivity increases elsewhere within the federal government, and we will make every effort to encourage this. We cannot, however, believe that the government will continue to attract and retain the caliber of workers who have been able to carry this country through war and peace and domestic political and economic crises, with efficient governmental service overall, if there is a drastic and unjustified diminution of benefits at precisely the time when the federal pay contract is proposed to be revised downward across the board.

In the interest of effective governmental operations, in the interest of justice to retirees who have invested their lives in the public service, and in the public interest, we urge that the present COLA arrangement not be attacked by Congress.

Senator STEVENS. We have been called to a meeting. We will be back in 12 minutes to 15 minutes, at the most. I hope you do not mind if we take a recess for that period of time.

[Recess taken.]

Senator STEVENS. Again, I give my apologies for the interruption.

Our next witness is James Hacking, assistant legislative counsel for Federal legislation of the National Retired Teachers Association and the American Association of Retired Persons.

Mr. Hacking?

**TESTIMONY OF JAMES M. HACKING, ASSISTANT LEGISLATIVE COUNSEL FOR FEDERAL LEGISLATION, NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY ROBERT O. BRUNNER, LEGISLATIVE REPRESENTATIVE**

Mr. HACKING. Thank you, Mr. Chairman.

I am the assistant legislative counsel for the National Retired Teachers Association and the American Association of Retired Persons, which have a combined membership of approximately 12.5 million persons, aged 65 and over.

Accompanying me this morning is my colleague, Mr. Brunner. He is an economist and legislative representative with our organizations.

I would like to submit my prepared statement for the record and in the interest of time, I would like to summarize my remarks.

Senator STEVENS. Without objection, your prepared statement will be placed in the record following your testimony.

Mr. HACKING. I would like to begin by observing that under the influence of the high and sustained inflation rate, which has been rising gradually over the past 15 years and is now at double-digit levels, the elderly household's income position and standard of living is declining.

The elderly's standard of living is declining in both real and relative terms and this decline is occurring despite so-called full cost-of-living increases in benefits payable under the major retirement and income support programs, including the Federal retirement programs.

The reason why this decline is occurring should be obvious. High rate inflation rapidly deteriorates the purchasing power of income components that are fixed. It also—although more gradually—deteriorates the purchasing power of components that are indexed.

That is so for two reasons. The first is the time lag that occurs in making adjustments in benefits. The second is that the Consumer Price Index, as structured, does not overcompensate—but very probably undercompensates—the elderly for the effects that inflation has on their budgets.

You must keep in mind, Mr. Chairman, that the elderly, with smaller family budgets, tend to spend larger budget shares on food at home, fuel and utilities, and medical care. These are items which have been rising at rates far in excess of the aggregate inflation rate as measured by the CPI.

In view of this situation, the associations cannot abandon their support for the cost-of-living protection that is presently available

under the Government programs, including the Federal retirement programs.

In our view, a cutback in the cost-of-living protection for Federal retirees would establish an ominous precedent and likely portend similar cutbacks in other indexed income support programs, like social security and SSI.

Moreover, we think that persons who retired counting on a continuation of twice-a-year adjustments in benefits should not have the rules of the game changed on them to their detriment. If such changes are to be made, they should be made only prospectively.

For the reasons I have mentioned, we cannot support S. 677, although I would acknowledge it is a well-intentioned measure, and would retain twice-a-year adjustments for persons age 65 and older.

On the other hand, however, it would work to the detriment of survivors. It would have what we call a ratcheting down effect on the benefit base amounts of persons who retire before the age of 65.

We agree that the early retirement trend among the elderly must be reversed, especially in view of the demographic shift that is taking place in the population. But the question of how to reverse the early retirement trend and encourage people to maximize their labor force participation should be addressed not through manipulation of cost-of-living adjustments, but rather should be addressed through the procedures and formulas used in determining initial benefit awards.

That, we think, is the proper way to go in dealing with the whole issue of early retirement and how to reverse the early retirement trend in the context of Federal employment. That issue should be addressed separately from the COLA issue.

Cost-of-living adjustments should be used solely to preserve the purchasing power of benefits once they are awarded.

I would like to finish my remarks by saying that the associations are fully supportive of Federal efforts aimed at reducing the rate of inflation. The elderly would benefit greatly from the success of such efforts.

In this regard we support bringing the Federal budget into balance and maintaining that balance over the business cycle. But a stringent fiscal policy, even in conjunction with stringent monetary policy, is not going to be enough to bring the inflation we are currently experiencing under control.

These macroeconomic tools are not by themselves or in conjunction with tax cuts sufficient to address some of the major factors that are contributing to the aggregate, double-digit rate of inflation.

The major factor contributing to the inflation rate right now is the wage/price spiral. Fiscal and monetary discipline and tax cuts do not have the kind of direct impact on the wage/price spiral that is needed to dampen inflationary expectations in the near term.

Therefore, given the fact that the elderly are sustaining very large inflation losses, before they are asked to sustain further losses and reductions in their living standards by having their cost-of-living adjustments cut back, the Government would have to have in place a comprehensive and effective anti-inflation program to bring the inflation rate down in the near term and keep it down over the long term.

Unhappily we think that such a comprehensive anti-inflation program is still lacking. We hope that one is put in place soon.

That concludes my remarks, Mr. Chairman. I thank you for this opportunity to present them.

Senator STEVENS. Thank you very muoh.

I do not have any questions.

I understand the position of your associations. They have made things very plain and very clear. I agree with them.

Thank you very much.

Mr. HACKING. Thank you.

[Mr. Hacking's prepared statement follows:]

NATIONAL RETIRED TEACHERS ASSOCIATION

AMERICAN ASSOCIATION OF RETIRED PERSONS

STATEMENT

OF THE

NATIONAL RETIRED TEACHERS ASSOCIATION

AND THE

AMERICAN ASSOCIATION OF RETIRED PERSONS

ON

S.677
CIVIL SERVICE COST-OF-LIVING
ADJUSTMENT ACT OF 1981

BEFORE

THE SUBCOMMITTEE ON CIVIL SERVICE

AND GENERAL SERVICES

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

APRIL 1, 1981

Mildred Moore
President NRTA

Olaf J. Kaaso
President AARP

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Executive Director

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INTRODUCTION

The Senate Budget Committee has included the Administration's recommendation to reduce the civil service cost-of-living benefit adjustment from twice-a-year to once-a-year in the Revised Second Concurrent Resolution on the Budget for FY81, FY82 and FY83. As an alternative to annualizing the benefit adjustments, the subcommittee has before it S.677, the Civil Service Cost of Living Adjustment Act.

The Associations cannot support either of these proposals or any other recommendations which would reduce cost of living protection for federal retirees. Any tampering with or capping of the twice a year cost-of-living adjustment will accelerate the erosion in the purchasing power of the benefits of these retirees. When the average employee annuity is approximately $10,000 a year and the average survivor annuity is under $5,000 a year, this taxable income hardly represents excessive benefits. Approximately one-third of the annuitants receive benefits of less than $6,000 a year. For many, many older persons, the present civil service retirement program sustains them above the poverty threshold.

As curtailments in the cost-of-living protection available under major income support programs, including the federal retirement programs are debated, the Congress must carefully consider the potential consequences. For the elderly beneficiaries of the programs, those consequences will entail an acceleration in the erosion that is already occurring in their real income situation. High rate, sustained inflation is pushing the elderly down on the income distribution scale by dissipating the purchasing power of all the components of their income, but especially those that are fixed. As a result, they find

themselves increasingly dependent upon government income maintenance programs that are indexed. To the extent that the indexing that is available to them is "capped" or otherwise limited, the erosion in their real income situation will accelerate.

INCOME GAINS MADE IN THE PAST ARE BEING ERODED

Rapid growth and expansion of government income support programs during the late 1960's and early 1970's caused the elderly's average income to rise over the past decade in real terms and in relative terms (relative to the income of the younger population). This trend was confirmed by a 1980 study entitled "Inflation and the Elderly", which was prepared for NRTA-AARP by Data Resources, Inc. (DRI).

According to the DRI study, average elderly income (in aggregate terms) managed to keep pace with, and slightly exceed, the inflation rate from the late 1960's into the late 1970's. Taking into account the incomes of elderly persons newly retiring during this period, as well as elderly persons already retired, aggregate elderly incomes rose at an average annual rate of 7.7% versus an annual CPI rate of 6.1% over the period 1967 through 1976. As a result, the average income of those over age 65 increased from about 48% of the average income of the non-elderly in 1965, to about 55% by the end of the 1970's - just about where the elderly's average income had been in the mid-1950's.

As for the future, however, the income situation for the elderly appears bleak. In the study previously cited, Date Resources, Inc. (DRI) forecast that even if current government programs remain in place with no legislated cutbacks, the elderly's share of income

relative to that of the nonelderly will decline sharply beginning in 1981. While the reasons for this decline are complex, the major factor remains the continuing high rate of inflation.

Although, in the past, much progress was made in improving the income status of the aged and reducing the incidence of poverty among them, the recent statistics and forecasts indicate that the elderly are most vulnerable to inflation, that they are sustaining disproportionately larger losses as a result of it, and that a rapid erosion of progress made in the past has already set in.

INADEQUACIES OF INDEXING

Despite the elderly's high and increasing degree of dependence on government income support programs which are indexed, these public programs do not fully compensate recipients for the inflation losses incurred with respect to program benefits. Although civil service benefits and those of other public programs are indexed to the Consumer Price Index (CPI), they are not fully protected against inflation for two reasons: first, benefit adjustments occur long after the inflation has had its effect on the purchasing power of the benefits; and second, the standard used in making the adjustments, the CPI itself, we believe does not accurately reflect the impact that inflation is having on the budgets of the elderly.

Under the current civil service retirement system, cost-of-living adjustments are received by annuitants every April and October. The adjustment provided in April is based on the increase in the CPI that occurred from June through December of the preceeding year and the adjustment made in October is based on the increase in the CPI that occurred from the preceeding December through June period. In each case civil service retirees must wait up to 10 months to be compensated

for the impact of inflation on their benefits. Any delay in adjusting for benefits, particularly when inflation is at high levels, causes a cumulative erosion in real benefits for these annuitants.

This erosion in real benefits is further compounded by the inadequacies of the CPI which does not take into account the particular expenditure patterns of the elderly. The study prepared for us by Data Resources, Inc. (DRI) on the elderly's expenditure patterns indicates that the general CPI tends to understate inflation's impact on elderly budgets. This occurs because the elderly, as compared to younger consumers, spend more of their income in three categories of expenditures - food at home, fuel and utilities and out-of-pocket medical expenses - items the prices of which have been increasing at rates well in excess of the rate of increase in prices in general.

Statistics from the DRI Study indicate that, since 1970, the cost of living for the elderly has risen faster than the cost of living for younger consumers. Between 1970 and 1979, the Bureau of Labor Statistics all-urban CPI rose an average 7.2% rate compared to 8.3% for food at home, 9.4% for fuel and utilities, and 7.9% for medical care. These costs have risen at a composite rate of 8.4% per year versus a CPI increase since 1970 of 7.2% per year. The DRI study further indicates that the adverse effects of this high inflation rate among the core necessities are greater for the poorest and the oldest of the elderly who, because of their lower incomes, have less flexibility in altering their spending patterns in response to higher prices.

Since higher inflation in the core necessities is expected to continue in the 1980's, the CPI's understatement of inflation's impact on elderly budgets will continue as well. For 1979 through 1985, DRI

has forecast an 8.7% rise in food at home, 9.9% for fuel and 10.1% for health care, compared to an 8.7% rise in the overall CPI.

In a recent study by Bridges & Packard of the Social Security Administration (published in the January 1981 Social Security Bulletin) it was found that, over the period 1967-1979, an index, specially constructed for older consumers (CPI-O) to reflect more accurately their expenditure patterns, grew slightly faster than the economy-wide or general CPI-W. The findings of this study are consistent with the findings of other recent studies on this subject. The following table reflects their research:

Table 1.—Constructed consumer price indexes: Annual indexes and percentage changes, 1967–79
[1967 = 100.0]

| Year | CPI-O | | CPI-$W_c$ | |
|---|---|---|---|---|
| | Index | Percentage change | Index | Percentage change |
| 1967 | 100.0 | ..... | 100.0 | ..... |
| 1968 | 104.2 | 4.2 | 104.2 | 4.2 |
| 1969 | 109.9 | 5.5 | 109.9 | 5.5 |
| 1970 | 116.5 | 6.0 | 116.2 | 5.7 |
| 1971 | 121.7 | 4.5 | 121.2 | 4.3 |
| 1972 | 125.7 | 3.3 | 125.1 | 3.2 |
| 1973 | 133.1 | 5.9 | 132.3 | 5.8 |
| 1974 | 147.9 | 11.1 | 147.0 | 11.1 |
| 1975 | 162.0 | 9.5 | 160.2 | 9.3 |
| 1976 | 172.0 | 6.2 | 170.6 | 6.2 |
| 1977 | 183.5 | 6.7 | 181.7 | 6.5 |
| 1978 | 197.6 | 7.7 | 195.2 | 7.4 |
| 1979 | 219.9 | 11.3 | 217.7 | 11.5 |

(Source: Bridges, Benjamin and Packard, Michael D., "Price and Income Changes for the Elderly", Social Security Bulletin, January 1981, page 4.)

Bridges & Packard, however, acknowledged the inherent weakness of their specially constructed CPI-O. In constructing this index, the authors merely reweighted the seven major expenditure categories of the general CPI to reflect the elderly's different expenditure patterns in these seven aggregate categories. In order to produce a more accurate

and valid older persons index, these seven expenditure categories must be pulled apart - or disaggregated - into more expenditure classes and then re-weighted to resemble the elderly's spending patterns. At the present time, an economist, Dr. Thomas C. Borzilleri, is conducting this type of research for our Associations.

RATIONALE FOR ASSOCIATIONS' OPPOSITION TO PROPOSALS TO ALTER THE COST OF LIVING PROTECTION AVAILABLE UNDER THE CIVIL SERVICE RETIREMENT SYSTEM

The elderly's real income situation and their standards of living are declining. This deterioration is occuring despite the provision of relatively "full" cost-of-living increases by the major income support programs including Federal retirement programs. For these reasons, the Associations cannot support any recommendation which will reduce cost-of-living protection for civil service retirees.

Our resolve in this matter is reinforced by a number of other factors we deem significant. First we would remind the subcommittee that federal retirees got twice-a-year adjustments as a substitute for the even more generous (and costly) mechanism with its 1% add-on that used to apply; having thus suffered a scaling back of the cost-of-living protection just a few years ago, federal retirees should not be forced to forego even more. Second, as a matter of principle, the Associations believe that persons who retired, counting on the continuation of twice-annual adjustments, should now have the "rules-of-the-game" changed on them to their detriment. Finally, we must point out that a cutback in cost-of-living protection for federal retirees would set a bad precedent and raise ominous prospects for cutbacks in cost-of-living protection available among other (and much larger) programs like social security.

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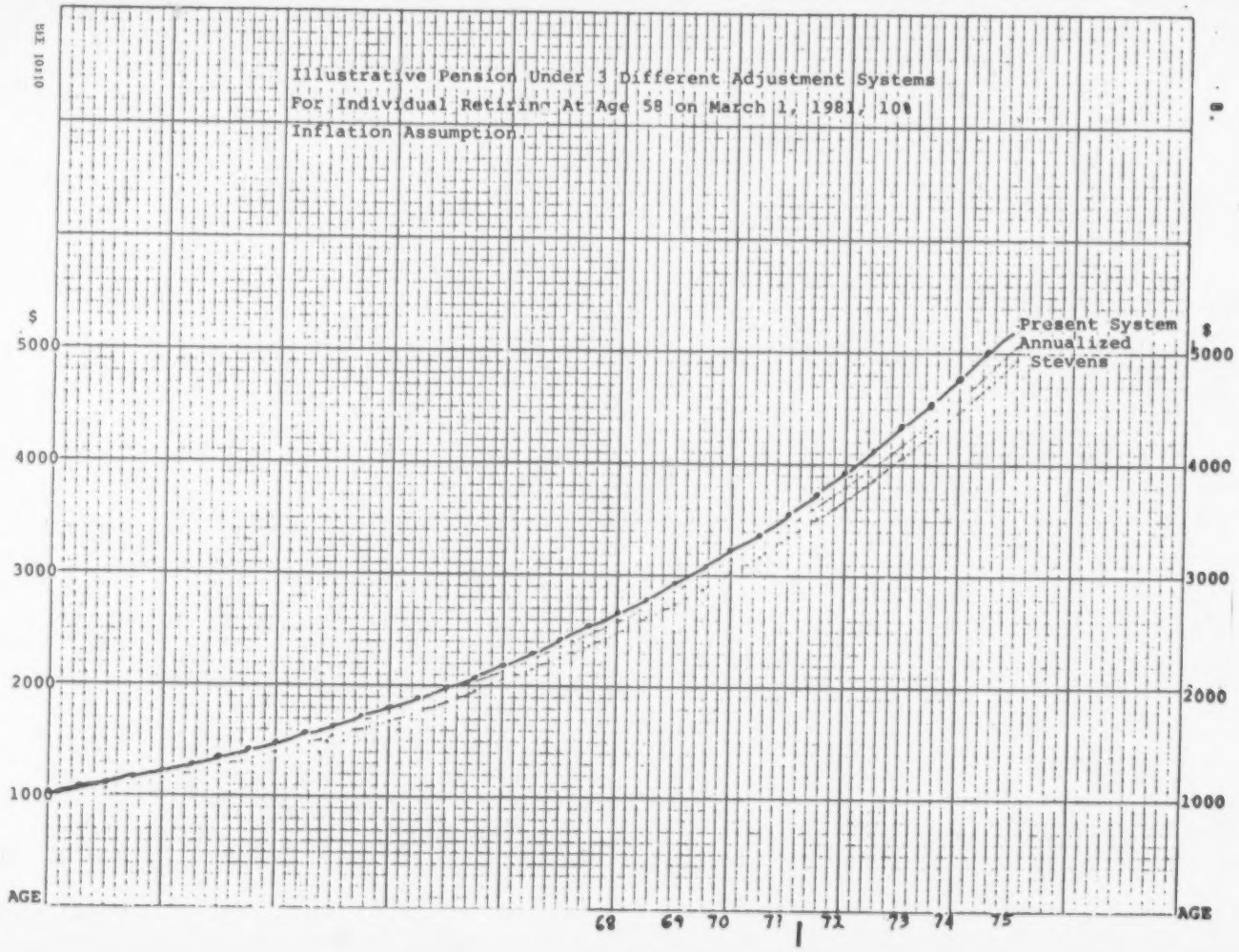
S.677 CIVIL SERVICE COST-OF-LIVING ADJUSTMENT ACT OF 1981

As Associations which do and will continue to represent thousands of civil service retirees, we cannot support S.677. In our view, the bill ignores a very vulnerable group of citizens - the spouses of those who have died during careers of federal service. It also would penalize those who are mandatorily retired early by the government. Finally, and most importantly, the bill would have a "ratcheting down" effect on real benefit levels for those persons who are between the ages of 60 and 65 and an excessive "ratcheting down" effect for those persons between the ages of 55 and 60. As Senator Stevens accurately pointed out in his floor statement on March 10, "...savings in the outyears through enactment of this bill will be considerably more than that generated by annualization". These savings will be provided by permanently and more severely reducing the benefits for present and future civil service retirees under age 65.

To determine how severe these benefit cuts would be over a retiree's lifetime, we compared benefit levels under the present system, an annualized system and the system proposed in S.677 for a hypothetical civil service worker who retires on March 1, 1981, at the age of 58. For simplicity we assumed that he would receive $12,000 annually or $1,000 a month (which is above average) from the civil service retirement program. We also assumed a 10 percent annual rate of inflation.

The following chart demonstrates how severe these benefit cuts would be. Assuming that the retiree would begin his retirement by receiving $1,000 a month (annual adjustments would reflect only 1/2 of the increase in the CPI until the retiree reaches age 60), he would experience a reduction in benefits of $1,260. Under an annualized


Illustrative Pension Under 3 Different Adjustment Systems
For Individual Retiring At Age 58 on March 1, 1981, 10%
Inflation Assumption.
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Annualized
Stevens
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system, he would lose $460 over the same period.

Between the ages of 60 and 65, S.677 would provide this same retiree with a full CPI adjustment once a year. But because the adjustments would be made on a lower base (due to the reductions he experienced over the previous period), the retiree would continue to experience a loss of retirement income. Over the five year period, the cumulative loss would total $8,358 as compared with a loss of only $3,738 under an annualized system.

Even twice a year adjustments from age 65 on would not compensate a retiree in this situation for the cumulative losses sustained. At age 70,the retiree would still have experienced a cumulative loss of $17,976 under S.677 ($10,506 under an annualized system).

As this chart demonstrates, S.677 would have a significant ratcheting down effect on real benefit levels. There are, however, two ways in which this problem could be addressed - through a catch-up provision or through less severe reductions in earlier retirement benefits.

We understand that the purpose behind limiting the annual benefit adjustment to 50 percent of the CPI for persons between the ages of 55 and 60 is to discourage early retirement. However, if federal workers accept the sacrifice that S.677 would impose and retire early, there is no reason why this sacrifice should be prolonged into their later years.

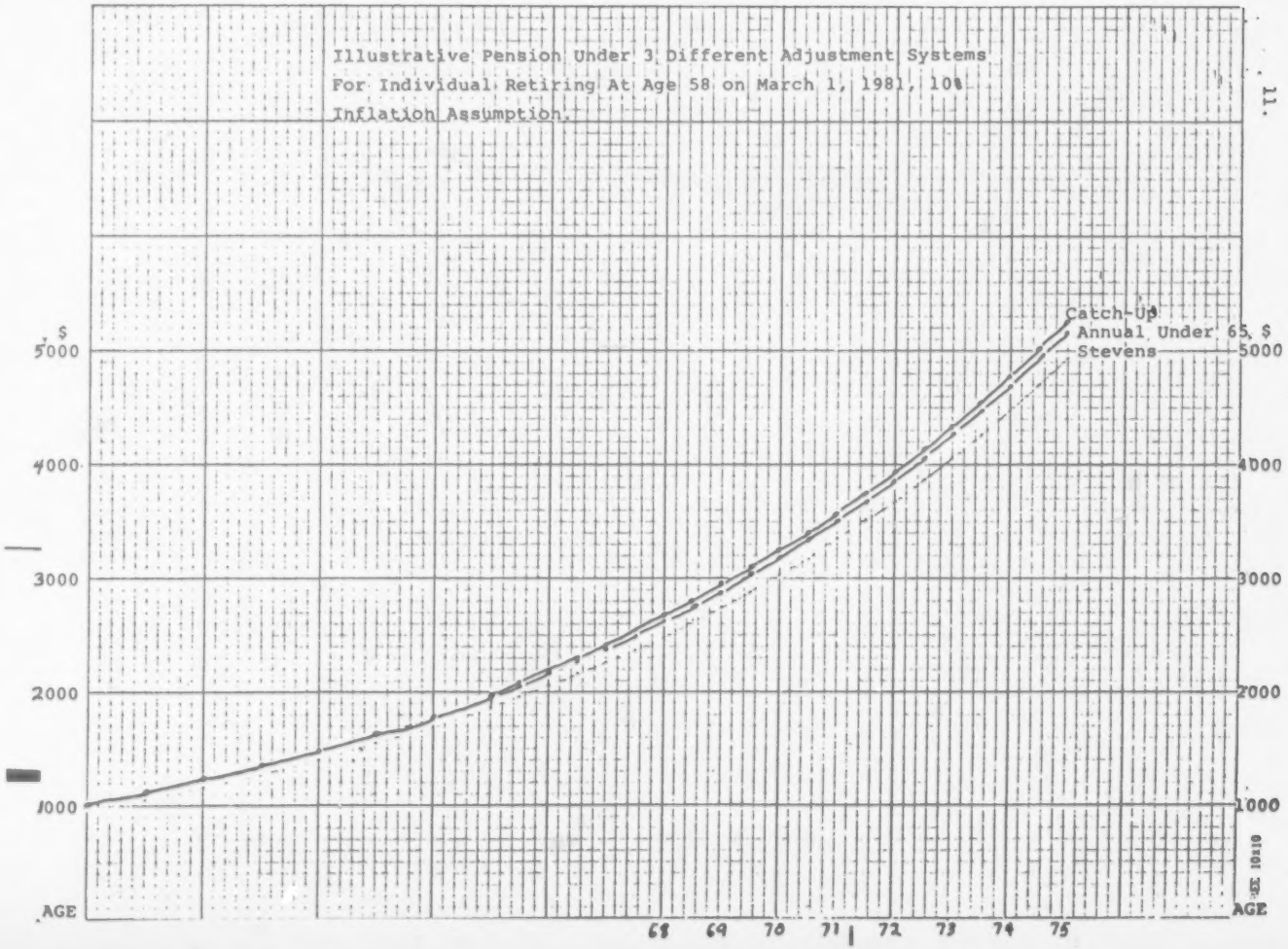
At age 65, such persons could be allowed to "catch up" and receive full benefits. They would not be allowed to recoup their losses prior to age 65, but they would automatically move up to the benefit level they would have received had they not taken early retirement.

For the person who retires from federal service at age 58 and retires from a second job at age 65, he would continue to receive reduced civil service benefits until age 65. The cumulative loss up to age 65 would be identical to the loss sustained under the scheme of S.677, i.e. just prior to full retirement at age 65, he would have received $8,358 less in benefits. He would be receiving about $194.00 less per month at this point. As the attached chart demonstrates, his retirement benefits would be lower until age 65, whereupon his benefits would move up to the base amount that would have obtained under present law.

Another alternative which would address the "ratcheting down" effect on benefit levels would be to provide a full CPI adjustment once a year, for all persons under age 65 and a full CPI adjustment twice a year for all persons over age 65. Not only would this proposal have the advantage of simplicity, it would impose a less harsh penalty on those who leave federal employment before age 65. The ratcheting down would be lessened.

As the chart indicates, a person retiring before age 65 would experience a reduction in benefits, though less severe than under S.677. At age 60 (if he retired at age 58), he would have received $460 less and by age 65, he would have experienced a cumulative loss of $3,738. Certainly this is less severe than the reductions under S.677 (at age 60, $1,260 in losses; at age 65, $8,358 in losses).

This possible alternative, however, would not benefit persons from age 65 on to the extent that the catch-up alternative would, because the semi-annual adjustments that would occur from that point on would be made on a lower benefit base amount. Nevertheless the effect is less severe than what would occur under S.677 and also less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Stevens
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severe than what would occur if a simple one-a-year adjustment were used throughout.

CONCLUSION

While S.677 does recognize the vulnerability of those 65 and older to high rates of inflation, it would create a new set of problems for those who begin to draw benefits before that age. Those who retire before age 65 (and especially those who retire before age 60), would not only lose benefits until they reach age 65, but they would continue to receive lower retirement income throughout their remaining years. Of course, as has been indicated, there are ways to ameliorate the "ratcheting down" effect that S.677 would have on benefit base amounts. Nevertheless, the Associations cannot abandon their support for the continuation of semi-annual adjustments for federal retirees. They, like the rest of the elderly, are sustaining significant losses as high rate, sustained inflation diminishes the purchasing power of their income and erodes the nature of the assets they accumulated and put aside to help provide themselves with sufficient income during their later years of life.

Clearly the Associations support federal efforts aimed at reducing the rate of inflation since the elderly population in particular would benefit from such action. In this regard, our Associations support a careful budget cutting policy; however Congress should realize that fiscal policy alone cannot cure the inflation problem. Reducing cost-of-living increases for federal retirees and thereby federal spending will not reduce inflation; before this group of elderly are forced to sustain a further deterioration in their living standards, the government would have to be pursuing a comprehensive anti-inflation strategy that would be effective and provide for an equitable sharing of any necessary income reduction. As far as our Associations are concerned, such a comprehensive anti-inflation program is still lacking.

Senator STEVENS. Our next witness is Kenneth Blaylock, president of the American Federation of Government Employees.

Mr. Blaylock?

**STATEMENT OF KENNETH T. BLAYLOCK, PRESIDENT, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, ACCOMPANIED BY KIMBERLY C. PARKER, LEGISLATIVE REPRESENTATIVE**

Mr. BLAYLOCK. Thank you, Mr. Chairman.

Thank you for the opportunity to present the views of the American Federation of Government Employees on S. 677 and also the views of public workers and unions which are affiliated with public employee departments of the AFL–CIO.

I would like to summarize my testimony and would ask that my formal statement be entered in the record.

Senator STEVENS. Without objection your prepared statement will be inserted following your testimony.

Mr. BLAYLOCK. I would also like to express my appreciation to you, Mr. Chairman, for trying to find some alternate solutions to the problems that we do face with the Federal retirement system and the social security and other retirement systems in this country.

We all know we do have problems. We are appreciative of the fact that you are trying to find solutions to those problems.

Senator STEVENS. Thank you.

Mr. BLAYLOCK. As you know, during the past few years, Federal employees had witnessed attack after attack on their compensations and their fringe benefits packages.

I have some deep concern that that attack continues and there is a concentrated effort to sharply reduce the standard of living for employees, personnel, who have served their country long and well. These people have paid their dues. These employees have made their contribution to a retirement system that they felt would be financially sound and available once they reached that point at which they were eligible to retire. I refer to the proposal that threatens the financial security of the career civil service annuitants.

We had great hopes that when the new administration came into office that they would keep its faith with the career civil service worker. In fact, we were quite pleased that during the period prior to the November elections the Republican candidate pledged to preserve the current biannual formula for adjusting civil service retirement annuities. We are now concerned, however, with the rush to balance the budget and to reduce the Federal deficit we seem to be back to things as usual and those commitments have been forgotten.

From the Federal employees point of view, the Federal Government seems to be an equal employment employer. They are sure bipartisan. We have been shafted by Democrats and Republicans alike. We are used to that.

I will not recap the civil service retirement system plan which is included in my testimony. You are just as familiar with that as I am.

But you will recall that in 1969 the act was amended to compensate retirees for the purchasing power that they lost during the waiting period when we were in a period of inflation, or inflation escalation.

Public Law 91-93 authorized that the additional 1 percent of the adjustment figure be added to the annuity. That was the kicker that we are all familiar with.

In 1976, over the opposition of the Federal workers and their unions, Congress voted to abolish the add-on or the kicker, claiming it was overcompensating. But then to compensate the employees for the additional cost of living during that period of time between adjustments, they did go to the twice-a-year COLA adjustment.

There is also another element of that that has not been mentioned so far here today. If you will recall, in 1969 when that act was amended, the Federal employees' contribution was raised from 5.5 percent to 7 percent to actually fund that benefit. Now that it is proposed to eliminate the COLA, it seems we are forgetting the fact that the Federal employees have paid a larger share of contributions into the fund to pay for that benefit.

We have some problems with S. 677. Several of those problems are these:

One, it does not take into consideration a large group of Federal workers that are required by law to retire early. These include law enforcement officials. I know you are very much aware of that. We would suggest that adjustments need to be made in that area.

We also have a problem with the fact that the formulas for the adjustment are based strictly on age. We think you should seriously consider making adjustments not only on age, but also take into consideration the actual compensation that the person may be receiving both from retirement and from private sector employment.

We are talking about maintaining a standard of living. Age is not a total basis for criteria for making those determinations. The proposal would aggrevate the financial burden borne by retirees already trying to manage on a severely restricted income, if not in financial ruin to many.

In addition, by allowing no distinction for categories of retirees who have failed to take into account those classes who do have to retire by virtue of statute.

In conclusion, I would like to point out that in the Federal Government the retirement system is being used as a personnel tool of management in a way that would never be allowed in the private sector. In fact, Congress has passed laws assuring the benefit levels of a retirement system and assuring financial security of the system.

Originally, the civil service retirement system was designed to insure that the Federal Government would attract and retain a qualified work force and guarantee those personnel that they would have an adequate standard of living upon leaving the career service.

It now is being used simply as a tool to help balance the budget. We think that is wrong and we think there is a broken commitment there.

What is most disturbing is that there are few options available for those in the civil service who wish to shore up their future financial security. If the President's budget recommendations were adopted in their entirety, minimum social security benefits for Federal workers would be eliminated.

The additional part-time job does little to protect the retirement income. It is also becoming difficult to leave Government service in the current job market.

Mr. Chairman, I would like to emphasize that once the credibility of the retirement program is gone, so is the credibility of the employer.

It is impossible to expect to have a good Government if the Federal work force becomes decreasingly demoralized. We, therefore, suggest that these considerations be taken into account before any change is made to the civil service retirement program.

Thank you very much for the opportunity to appear here today. I would be glad to try to answer any questions you may have.

Senator STEVENS. Thank you very much.

You have a good concept of trying to find another factor to put into this approach—the approach of the bill—another factor in the sense of income levels from nonretirement income. That would be difficult to do, but we will take a look at that.

Mr. Blaylock, we are still trying to see if there is some way to find an approach that would lessen the impact of the loss of the twice-a-year adjustment.

I just think if we don't come up with an alternative, that it will be practically an impossibility to block annualization this year. We did last year. We did the year before. I do not see how we possibly can do it this year.

One of the problems is that the Congressional Budget Office has reported to the Senate that the true retirement costs for current employees account for over 35 percent of the payroll, of which 7 percent is contributed by employees. Have you made a study of that in your organization?

Mr. BLAYLOCK. We are very much aware of the arguments which went on about 3 years ago when the accounting cost system for the retirement was changed. We went from a static formula to a so-called dynamic formula.

Previous witnesses have alluded to the actual cost. In reality, if you look at the figures for last year, the amounts of money going into the retirement trust fund from employer-employee contributions and the interest on those funds, there were some, as I recall—it seems to me the figure was a $6 billion surplus.

We paid the annuities last year. It was very much in a sound financial basis. If you want to accept the dynamic formula projecting the overall cost of an employee's retirement across a 30-year or 35-year work period, the arguments are which formula should be used?

We talk real dollars and the actuaries in that case are the dynamic formula. In reality, the only money the Federal Government put into the retirement system last year was the 7 percent they paid and the interest they paid on money they did not put into it when they were supposed to put into it.

That is the actual dollars which you appropriated right here in Congress that went into that fund. If you listen to the actuaries' arguments, they are saying that you actually incurred a lot more debt last year.

We do not agree with that. We never have agreed with that. Now we are seeing the dynamic formula used, as you well know, also as a justification for contracting out in developing in-house costs.

One of the problems I have with your proposal and with other proposals that are floating is that they are bandaids on a very severe wound. The overall needs to be dealt with.

There is no doubt—and we would totally support this—that an actuarially sound financial program for the civil service retirement plan is needed. It is in our interest. People must be guaranteed that that program will be there when they need it.

We have yet to see an in-depth study by Congress to really develop an actuarially sound financial funding benefit level program. There are many personnel programs that have been built into our retirement system that have added costs to it.

There are credits for time in military service that probably half the work force carries. There is no money which transfers into the fund for military credits.

That is a heavy burden. That is not even a part of the civil service retirement system. That was a decision made by Congress that they would do that to make the military service more attractive.

Funds should be transferred into this fund if those credits are going to be allowed. Early retirement should have been used by Federal agencies for many years.

At one time there was a concept floating that we should be encouraging the old employees to get out so new ones can come on. Early outs have been used. In some cases this has been rightly so and in many cases very much abused.

There was no funding provided for that benefit. There is a series of those personnel items that are in our program that really are not part of our retirement system. We think a serious look needs to be taken at actually funding our system.

We think the contribution levels of the employer and the employee are adequate. When you look at private sector plans, you see many plans with funding levels of roughly that level and benefit levels which are fairly equivalent.

Senator STEVENS. You are right, partially, so far as my understanding of the dynamic system is concerned.

The difficulty is that under the dynamic system you have the Panama Canal Commission, the D.C. Government, the Farmers Home Loan Bank, and others who do not contribute fully to the retirement system.

Yet they are in it. I wonder sometimes. According to my staff, there is a $3 billion shortfall. Employees who are covered by the retirement system and do not contribute to it are in that. Here we are going to do away with COLA for the retirees to save $500 million.

I really have some serious problems with these suggestions.

I look forward to working with you and other organizations as we do approach the whole question of the retirement system. I

really think we should look at it and start afresh, at least for the new people coming in. Let us keep our commitments to those who are now there and start a new system partially based on a modified Keogh plan. If people want to save more and have a greater retirement system for themselves, let them do it on a tax-deductible basis as we do with the Keogh system.

Incidentally, Mr. Cowen points out that I made an error there. The employees in the off-budget agencies do contribute to the retirement system. The employing agencies do not. The employer contributions by the Panama Canal Commission and by others do not meet the true costs.

Mr. BLAYLOCK. The employees do make their contributions.

Senator STEVENS. The employers are not making the contributions.

Mr. BLAYLOCK. You would not allow that in the private sector.

Senator STEVENS. No, you are right. It could not be done. As a practical matter, they are budgeted as other agencies are budgeted. These costs are roughly equivalent, but they are not making full contributions to the system.

Mr. BLAYLOCK. Mr. Chairman, I would suggest that you look at the financing of the system. I am talking about such things as setting the retirement system up similar to the ERISA system where you have a trust set up where you have employee participation on that trust, the administration, and the investment.

I would suggest you take a look at the investment practices. Right now we have a paperwork transaction within the Treasury. No money changes hands. The Federal Government continues to use that money.

Yet, the fund gets no interest on that money. When you look at the investment levels—and this administration is talking about very heavily reindustrializing America. The $64 billion that is in that trust fund now—What would that do if it were invested in the private money market to help reindustrialize America?

We probably could be getting 14 percent interest instead of 5.5 and 7 percent.

Senator STEVENS. You are absolutely right. The COLA problem only comes about because of the restriction on employee management of their own retirement fund.

The State employees in Alaska's association bought gold. They invested their own money. They do not have any cost-of-living adjustment problems. They go up and down so far as the interest rates are concerned, but in times of inflation they keep up with inflation by their investment.

Mr. BLAYLOCK. As a representative of about 700,000 Federal workers I would like very much to sit on a committee that had some say so in how that money was invested.

Senator STEVENS. We will try to work that out.

Thank you very much.

Mr. BLAYLOCK. Thank you.

[Mr. Blaylock's prepared statement with an appendix and a letter to Senator Stevens follow:]

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES
Affiliated with AFL-CIO
1325 Massachusetts Avenue, N.W., Washington, D. C. 20005

STATEMENT OF
KENNETH T. BLAYLOCK
NATIONAL PRESIDENT
AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES

SUBCOMMITTEE ON CIVIL
SERVICE AND GENERAL SERVICES

ON S. 677

APRIL 1, 1981

I am pleased to be able to appear here and testify on behalf of the 700,000 workers represented by the American Federation of Government Employees, AFL-CIO. Today I also speak for hundreds of thousands of federal career civil service annuitants who face the future with some trepidation.

As you know, during the past few years, federal employees had witnessed attack after attack by the Carter administration on their pay and fringe benefits. I will not mention here the numerous proposals to destroy the principle of pay comparability between the public and private sector, or to increase the level of contracting-out of government jobs with no regard to cost effectiveness and the morale of federal workers.

Of equal concern has been the concerted effort to sharply reduce

The standard of living of those personnel who have served their country long and well. I refer here to proposals which would threaten the financial security of career civil service annuitants.

Since 1976, the pressure has been steady and relentless. In that year Congress decreased the Retirement Income Credit for federal retirees, and eliminated the one-percent cost-of-living supplemental adjustment designed to help annuitants keep abreast of inflation. Also in 1976, Congress excluded federal workers from eligibility for disability exclusion. And in 1977, the offset for spouses of Social Security recipients who were also on civil service retirement rolls was enacted.

AFGE had great hopes that the new administration would keep its faith with the career civil service. Federal workers and retirees were pleased that, during the course of the presidential election, the Republican nominee pledged to preserve the current bi-annual formula for adjusting civil service retirement annuities. But we are now concerned that in the rush to balance the budget and reduce the federal deficit, such commitments may be forgotten, and the twice-annual COLA eliminated.

We also fear that in the current climate even more harmful proposals may, in haste, be enacted into law. In this context, we feel obliged to point out that the legislation recently introduced by the distinguished Chairman of this committee, S. 677, contains some features which would prove detrimental to federal retirees.

As you know, the Civil Service Retirement System was established by Congress in 1920 for the purpose of providing annuities, at retirement, to employees of the Federal government. From the System's inception in 1920, and for a 42 year period thereafter, however, Congress provided no statutorily regulated mechanism for adjusting retirement annuities to reflect substantial increases in the cost of living. Because of the lack, during that period, annuities were adjusted only sporadically and the amount of the increases authorized by the Congress was only loosely aligned with escalations in prices.

It was not until 1962 when Congress enacted Public Law 87-793, that a system was established to provide that annuities be adjusted on a regular basis. Public Law 87-793 provided that, effective April 1 of each year, civil service annuities would be increased automatically whenever the Consumer Price Index (CPI) rose 3 percent above the CPI in the base year. Congress required, however, that an annuitant must have been retired for at least a year to be eligible for the adjustment.

That one year waiting period was waived three years later, however, with the enactment of Public Law 89-205 in 1965. That legislation also revised the mechanism which triggered annuity increases by requiring that adjustments be based on monthly rather than yearly increases in the Consumer Price Index. Under the formula devised in 1965 if the CPI increased by 3 percentage points or more and held at that level for three consecutive months, the highest point the CPI reached during that three month period would determine the size of the

annuity adjustment. The adjustment became effective three months later.

Because this system resulted in a five month delay between the time the annuity adjustment was calculated and the time it was reflected in the annuity checks, Congress, in 1969, further amended the Retirement law to compensate retirees for the purchasing power their annuities lost during that waiting period. Public Law 91-93 authorized that an additional one-percent of the adjustment figure be added to the annuity. The purpose of this additional increment - the "kicker" as it was called - was to restore the purchasing power of the annuities which was diminished significantly in the five month period which lapsed after the CPI triggered annuity increases. In our view, this action also signified Congressional recognition of the equity of insuring that Federal annuities kept pace with inflation and maintained a constant value.

However, in 1976, over the opposition of AFGE and other employees' organizations, Congress voted to abolish the add-on, claiming that it was overcompensating Federal annuitants for the effects of inflation. While we did not support the decision to eliminate the "kicker," we were gratified that Congress attempted to minimize the damage inflicted by its action by stipulating that future adjustments would be made twice a year and would reflect, exactly, the change in the Consumer Price Index.

In our view, when the 94th Congress altered the cost-of-living adjustment formula and instituted the system we have today, it made a solemn commitment to Federal retirees that it would continue to

guarantee the monetary value of their annuities. Yet, that commitment appears to have waivered - if not disappeared altogether - as we have recently witnessed a successive series of proposals to alter the COLA formula by annualizing the adjustment or altering the components which comprise the Consumer Price Index.

S. 677, introduced by the distinguished Chairman of this Subcommittee, is yet another proposal to alter the current cost-of-living adjustment formula, in this case, by establishing a three-tiered formula to calculate adjustments. The adjustments would be based solely on the age of the annuitant or the annuitant's survivor.

Under S. 677, retirees (or survivors) who are under age 60 would recieve annuity adjustments once a year. The adjustment would be equal to one-half the percentage change in the Consumer Price Index. Annuitants (or their survivors) who are at least age 60, but not yet 65, would receive annualized adjustments based on the full percentage of change in the Consumer Price Index. Annuitants aged 65 and over would continue to have their annuities adjusted under the current formula-twice a year based on the full percentage of change in the CPI. Upon review, we find that we cannot support this legislation.

S. 677 would penalize those employees who retire prior to age 65, as well as their survivors, solely on the basis of their ages. Federal annuitants, unlike Social Security pensioners, do not receive family allowances during their lifetimes and their survivors receive benefits only if the employee elects to draw a reduced annuity through his or her retirement years.

There are currently 788,000 persons on the Civil Service Retirement rolls who fit into this category -- including those who have retired for reasons of disability. Even using the rather conservative Reagan budget inflation assumptions, enactment of this legislation would, in Fiscal Year 1982 alone, cost these retirees (and their survivors) $541 million in lost adjustments. In addition, because this revised formula would have the sustained effect of reducing the base on which all future adjustments are calculated, the annuitant will never recover the full value of his or her annuity, even when he or she becomes entitled to full semi-annual adjustments upon reaching age 65.

With the inflation rate currently 12 percent, and the prime interest rate hovering near 18 percent, Federal annuitants and their survivors can ill-afford to sustain such decimation to the value of their annuities. This proposal would aggrevate the financial burdens borne by retirees trying to manage on already severely restricted incomes -- if not inflict financial ruin on many.

In addition, S. 677, by allowing no distinctions for categories of retirees, has failed to take into account those classes of beneficiaries who, by reason of statute, have no choice but to retire at ages earlier than 65. I refer primarily to those Federal employees who are in so-called "hazardous duty" positions in government service which are covered by Sections 8335 and 8336, Title 5, United States Code. (See Appendix 1). Occupations covered under these sections include Federal air traffic controllers, (5 USC 8335(a)), Firefighters, and all other classes of employees whose primary duties involve

investigating, apprehending or detaining persons suspected or convicted of Federal crimes, (5 USC 8335(b)).

Over the years, since the first "hazardous duty" retirement law was enacted in 1947, the category of occupations has been expanded to cover such employees as Customs and Immigration Border Patrol officers and airline pilots, game wardens, postal inspectors, Panama Canal Zone police officers, employees of Federal or District of Columbia detention facilities - including not only correctional officers, but all persons occupying positions within the walls of the facilities - Department of Justice parole hearing examiners, certain forestry employees, and many of the supervisory personnel in agencies employing persons in covered positions. In 1977, the General Accounting Office reported that there were 52,300 Federal employees who were in positions covered by "hazardous duty" retirement eligibility.

Accordingly, under the provisions of 5 USC 8331-8339, employees in these positions are eligible for an earlier retirement than non-covered employees, and in many cases - air traffic controllers, for example - these employees must be separated from service at an earlier age, regardless of the length of their service.

Clearly, by enacting special retirement incentives for employees in these positions initially, Congress took cognizance of the fact that the jobs performed by these individuals involved a higher degree of stress and risk than normal. The retirement incentive was enacted, therefore, to encourage employees in the covered occupations to leave Federal service before the hazards of their occupations caused them to cease to function efficiently. In these highly

specialized fields, it is vitally important that employees be performing at peak levels of efficiency. If the incumbent, after 20 years of service finds that he or she can no longer maintain a sustained level of efficiency, he or she can retire, making way for a younger individual. Thus, early retirement for these individuals has become an invaluable tool in helping the employing agencies maintain a young and vigorous workforce which is functioning at maximum efficiency.

Under the provisions of S. 677, an employee, like Dick Bevins, President of our Border Patrol Council, who will be mandatorily separated from service at age 55, would have to bear the financial loss of his annuity, of one adjustment, equal to only one-half of the change in the Consumer Price Index over the previous year, until he is 60 years old. At age 60, Mr. Bevins would receive an annual increase equal to the change in the CPI. Keep in mind, however, in the previous four years his base annuity was capped, resulting in significantly lower adjustments. It would take nine years after retirement for Dick Bevins to be eligible for semi-annual adjustments as we know them today, but even then, the annuity would never recover the value it lost during the preceeding eight years. I would like to stress that those personnel in the positions covered by hazardous duty retirement, can be expected to incur large medical bills even early in their retirement years.

Surely, it was not this Committee's intention to so punish those employees who, by virtue of the positions they occupy, must retire at ages earlier than 65, and do not have the option of continuing

to work to qualify for full semi-annual cost-of-living adjustments to their annuities. Nevertheless, that is exactly the effect enactment of this legislation would have on employees in these positions.

Finally we believe that the three-tiered system for calculating benefits proposed in S. 677 would be an administrative nightmare, causing vast amounts of additional paperwork to calculate the adjustments for differing age groups. The bill, in addition, would alter the period on which adjustments are calculated and in the first year calculations would have to be based on CPI changes on two fiscal years, rather than one. We already have ample evidence that it takes the Office of Personnel Management inordinate amounts of time to process annuity claims under the present system. With the additional slide-rule type of calculations this legislation would require, we cannot help but believe that the processing procedure would be lengthened still further.

In conclusion, I would like to point out that in the Federal government the retirement system is being used as a personnel management tool in a way that would never be countenanced in the private sector. Originally, the civil service retirement program was designed to ensure the federal government would attract and retain a qualified workforce, and to guarantee those personnel would have an adequate standard of living upon leaving the career civil service. Now it is being used as a source of funding to balance the federal budget, or, as has also been proposed, to prop up the trust funds in the Social Security system.

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What is most disturbing is that there are few options available for those in the civil service who wish to shore up their future financial security. If the President's budget recommendations are adopted in their entirety, minimum social benefits for federal workers would be eliminated, so the additional part-time job does little to protect retirement income. It is also becoming difficult to leave government service in the current job market.

Mr. Chairman, I would like to emphasize that once the credibility of the retirement program is gone, so is the credibility of the employer. And it is impossible to expect to have good government if the federal workforce becomes increasingly demoralized. I, therefore, suggest that these considerations be taken into account before any change is made to the civil service retirement program.

APPENDIX 1

Section 8335, Mandatory Separation

(a) An air traffic controller shall be separated from the service on the last day of the month in which he becomes 56 years of age. The Secretary of Transporation, under such regulations as he may prescribe, may exempt a controller from the automatic separation provisions of this subsection until that controller becomes 61 years of age. The Secretary of Transporation shall notify the controller in writing of the date of separation at least 60 days before that date. Action to separate the controller is not effective, without the consent of the controller, until the last day of the month in which the 60-day notice expires.

(b) A law enforcement officer or a firefighter who is otherwise eligible for immediate retirement under section 8336(c) of this title shall be separated from the service on the last day of the month in which he becomes 55 years of age or completes 20 years of service if then over the age. The head of the agency, when in his judgment the public interest so requires, may exempt such an employee from automatic separation under this subsection until that employee becomes 60 years of age. The employing office shall notify the employee in writing of the date of separation at least 60 days in advance thereof. Action to separate the employee is not effective, without the consent of the employees, until the last day of the month in which the 60-day notice expires.

(c) An employee of the Alaska Railroad in Alaska and an employee who is a citizen of the United States employed on the Isthmus of Panama by the Panama Canal Commission, who becomes 62 years of age and completes 15 years of service in Alaska or on the Isthmus of Panama shall be automatically separated from the service. The separation is effective on the last day of the month in which the employee becomes age 62 or completes 15 years of service in Alaska or on the Isthmus of Panama if then over that age. The employing office shall notify the employee in writing of the date of separation at least 60 days in advance thereof. Action to separate the employee is not effective, without the consent of the employee, until the last day of the month in which the 60-day notice expires

Section 8336, Immediate Retirement

(c)(1) An employee who is separated from the service after becoming 50 years of age and completing 20 years of service as a law enforcement officer or firefighter, or any combination of such service totalling at least 20 years, is entitled to an annuity.

AMERICAN FEDERATION OF
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IN REPLY PLEASE REFER TO

6p/COLA

April 10, 1981

The Honorable Ted Stevens, Chairman
Subcommittee on Civil Service and
General Services
Committee on Government Affairs
Suite 57, Congressional Hotel Annex
Washington, DC 20510

Dear Mr. Chairman:

On behalf of the members of the American Federation of Government Employees and the Public Employee Department, AFL-CIO, I wish to thank you for the opportunity to appear before your Subcommittee on April 1st and testify on S. 677, a bill to alter the cost-of-living adjustment formula for Federal annuities.

At the conclusion of our statement, staff requested that we clarify the Fiscal Year 1982 cost estimate attributed to S. 677 on page 6 of our prepared statement. Upon review, we find that the figure should read "$452 million" in Fiscal Year 1982. $541 million is the amount that Federal annuitants would lose under the Administration's proposal to annualize all cost-of-living adjustments. These figures were compiled by an independent actuary commissioned by the FAIR (Fund for Assuring an Independent Retirement) Research Committee and are predicated on the Administration's Budget inflation assumptions.

I hope that this clarification can be included in the hearing record. If you require any additional information, please do not hesitate to contact us.

Sincerely yours,

Ken Blaylock

Kenneth T. Blaylock
National President

Senator STEVENS. We now will hear from Vincent Connery, president of the National Treasury Employees Union.

Mr. Connery?

**TESTIMONY OF VINCENT L. CONNERY, PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION, ACCOMPANIED BY JERRY D. KLEPNER, DIRECTOR OF LEGISLATION, AND THOMAS TINSLEY, LEGISLATIVE ADVISER**

Mr. CONNERY. Thank you, Mr. Chairman.

I am Vincent L. Connery, president of the National Treasury Employees Union. I am accompanied here today by, on my right, Jerry D. Klepner, our director of legislation, and on my left, Thomas Tinsley, our legislative adviser.

I would ask that our prepared statement be inserted in the record.

Senator STEVENS. Without objection, so ordered. We will insert it following your testimony.

Mr. CONNERY. Our union is the exclusive representative of over 120,000 active and retired Federal workers. We are deeply disturbed that the semiannual cost-of-living adjustments, COLA, under the civil service retirement system, have once again become prime targets for those looking for ways to slash the Federal budget.

We had hoped that the debate on this issue, which occurred last year, had convinced Congress of the essentially fair nature of the present system.

Unfortunately, this does not seem to be the case. Today this subcommittee has before it S. 677, a bill which would institute a major change in the indexing mechanism of the civil service retirement system.

In addition, the Reagan administration has proposed the elimination of one of the COLA's as part of its budget package, a call which has been echoed by the Senate Budget Committee.

Mr. Chairman, our prepared testimony discusses at length the history and validity of the present indexing formula under the civil service retirement system. I would like to touch on several major topics.

Our union remains completely opposed to any modification of the current semiannual cost-of-living adjustments under the civil service retirement system.

We remind this subcommittee that the indexation of annuities based on movements in the Consumer Price Index was adopted by Congress as a means of imposing a degree of fairness and logic into what had previously been a haphazard politically influenced system of granting benefit increases.

The present semiannual COLA system was adopted by Congress in 1976 as a compromise. While Federal retirees gave up some of the protection against inflation afforded to them under the previous indexation formula, the regular semiannual COLA system provided annuitants with the knowledge of exactly when COLA's would be granted and the ability to plan their financial futures accordingly.

We believe that it would be an unconscionable breach of faith for Congress to erode this system further. This is the only protection against inflation that these retirees have.

Critics of the present indexation system justify their position by citing the budgetary savings that would result from the elimination of one of the COLA's. They also contend that it is unfair for the Federal retirement to be indexed twice a year, while social security and other programs receive only one annual adjustment.

While we deal with each of these misconceptions at length in our full statement, we feel compelled to address them briefly at this time.

We categorically reject the notion that Federal retirees have not sacrificed their fair share for the sake of budgetary savings.

Over the past 6 years Congress has enacted numerous provisions which have steadily eroded the benefits of these retirees. Last year alone Congress instituted changes in the civil service retirement system which will save an estimated $23 million in fiscal year 1981 and $324 million by fiscal year 1985.

We must also remind the subcommittee that civil service retirement, unlike social security and other Federal programs, is, and always has been, a staff retirement plan designed to provide a livable annuity to Federal retirees when their careers are over.

Interestingly enough, while many critics readily point out that civil service retirement is the only Federal program indexed on a semiannual basis, they rarely mention that it is also the only program subject to taxation at every level of Government.

While there are no precise figures on how much of these annuities are paid in taxes, a reputable actuarial study has estimated that at least 10 percent of the average annuity goes into Federal taxes and another 5 percent into State and local taxes.

Based on this information and figures supplied by the Office of Personnel Management, we find that retired Federal workers pay approximately $114.5 million in Federal taxes and survivor annuitants pay another $1.7 million.

We, therefore, categorically reject any notion that Federal retirees and their families are not sacrificing enough for the sake of the budget. On this basis we must oppose any attempts to further limit benefits under the civil service retirement system, including those contained in S. 677, which is now before the subcommittee.

S. 677 would retain the present system of semiannual adjustments for annuitants 65 years of age or over. Annuitants between 60 and 64 years would receive only the full March COLA, while those under 60 years of age would receive a single adjustment at the rate of 50 percent of the full once-a-year COLA.

At best, S. 677 is an attempt to soften the impact of the move to a once-a-year COLA. At worst, the proposal would result in a serious erosion of benefits under civil service retirement and could weaken some of the basic concepts that underlie that system.

Since its inception, civil service retirement has followed the basic principle that the benefits earned and received should be related to years of service and salary and that the purchasing power of these benefits should be maintained during retirement.

S. 677, however, departs from both of these principles. It establishes the new concept that those who are older are in greater need

of maintaining purchasing power on a more current basis than others.

By so doing the bill also provides that one's age, in effect, means more than salary and length of service in the amount of annuity received by an individual.

We believe that these effects of S. 677, though they may be unintended, erode the fundamental principle of the civil service retirement system itself.

In conclusion, we believe that the civil service retirement program already has been reduced enough over the years in various ways that have saved the Government millions of dollars.

We are extremely disappointed that Congress could consider tampering with the benefits of those who have served their Government well and, who by virtue of their station in life, are unable to defend themselves against the effects of inflation.

We must conclude, therefore, that any changes such as those outlined in S. 677, are unjustified, grossly unfair, and must be rejected.

The preservation of the fundamental precepts behind the civil service retirement system is the real issue behind the COLA debate.

Federal retirees and their survivors are now looking to Congress to preserve the integrity of their retirement system and maintain the U.S. Government's compact with these individuals.

We hope that the Congress will act wisely and equitably.

Mr. Chairman, this completes my statement. If there are any questions, my colleagues and I will be happy to answer them at this time.

Thank you.

Senator STEVENS. Thank you.

Mr. Tinsley, do you have any comments?

Mr. TINSLEY. No, Mr. Chairman.

Senator STEVENS. Mr. Klepner, do you have any comments?

Mr. KLEPNER. No, Mr. Chairman.

Senator STEVENS. I understand your position.

I am still searching for some way to soften the blow. I think it is going to have to come. So far as the Senate is concerned, I do not think there is any way possible to stop the annualization bill from passing.

Mr. CONNERY. That is very distressing news. I understand your position. We appreciate your position. That news is very disturbing.

Senator STEVENS. Thank you very much, gentlemen.

We appreciate your coming here today.

Mr. Connery, if the choice is still between S. 677, and annualization, I assume that you would prefer the annualization so far as your organization is concerned, is that correct?

If you had to make that choice, which would it be?

Mr. CONNERY. If we had to make that choice, yes, Mr. Chairman.

Senator STEVENS. Thank you very much.

[The prepared statements of Mr. Connery and Mr. Klepner follow:]

Statement of

Vincent L. Connery
National President

and

Jerry D. Klepner
Director of Legislation

National Treasury Employees Union

to the

Subcommittee on Civil Service and General Services
Committee on Governmental Affairs
U.S. Senate

Honorable Ted Stevens, Chairman

S. 677

Washington, D.C.

April 1, 1981

Mr. Chairman and Members of the Subcommittee, I am Vincent L. Connery, President of the National Treasury Employees Union. I am accompanied today by Jerry D. Klepner, NTEU Director of Legislation. Our union is the exclusive representative of over 120,000 active and retired Federal workers.

We are deeply disturbed that the semi-annual cost-of-living adjustments (COLA) under the civil service retirement system have once again become prime targets for those looking for ways to slash the Federal budget. We had hoped that the debate on this issue which occurred last year had convinced Congress of the essentially fair nature of the present system.

Unfortunately, this does not seem to be the case. Today, this Subcommittee has before it S. 677, a bill which would institute major changes in the indexing mechanism of the civil service retirement system. In addition, the Reagan Administration has proposed the elimination of one of the COLA's as part of its budget package, a call which has been echoed by the Senate Budget Committee.

Our union, however, does not believe that this desire to drastically change the indexing system for the civil service retirement program is either justified or desirable. We continue to maintain that the present semi-annual indexation is a vital and fair component of a sound staff retirement system. By tampering with one aspect of this program without a careful analysis of all the factors involved in Federal pay, compensation, and benefit practices, Congress is pursuing a course that will withstand neither intelligent scrutiny nor the test of fairness.

We believe that any reasonable analysis of the COLA issue must begin with an examination of the evolution of the current indexation process under the civil service retirement system. Prior to 1962, increases in Federal retirement benefits were enacted by Congress and approved by the President on an ad hoc basis with no consistent formula for determining such changes. By the early 1960's, this process was widely criticized as being subject more to shifting political pressures than either budgetary or equity considerations.

In 1962, P.L. 87-793 provided that civil service annuities would be increased automatically whenever the Consumer Price Index for a year exceeded the CPI in the base year by 3 percent or more. Originally, 1962 was established as the base year for indexation purposes, and a new base year was to be established whenever a new COLA was granted.

It is important for the Subcommittee to note that the Consumer Price Index was introduced into the civil service retirement system as a method of imposing discipline on what was previously a partisan, haphazard process of increasing retirement benefits. This was an important aspect of the initial rationale behind the present indexing system, and it is one which, we believe, remains valid today.

In 1965, the COLA formula was revised to base the adjustments on monthly, rather than yearly, movements in the CPI. The new law provided that whenever the CPI rose 3 percent above the level of the CPI for the month in which the most recent increase was granted, and remained at or exceeded 3 percent for 3 consecutive months, annuities would be increased by the highest monthly

percentage increase in the CPI during those 3 months. The increase would take effect on the first day of the third month following the 3 consecutive month period.

In 1969, Congress decided that the 5 month gap which existed under the 1965 amendments between the initial month when the CPI rose at least 3 percent and the effective date of the COLA was not providing the desired protection against inflation for annuitants. To compensate retirees for this lag, P.L. 91-93 provided that another 1 percent be added to each COLA on the date it became effective. In enacting this provision, Congress, particularly the Senate, set forth the policy that civil service annuitants should be compensated for the time lapse that occurred under the existing computation formula in a manner which enabled retirees to maintain their "standard of living." This was a significant attempt to keep annuities on a current pace with inflation instead of merely allowing them to catch up with changes in the CPI.

None of the revisions that were made in the civil service retirement system in the 1960's, however, anticipated the high inflation rate of the 1970's. By 1976, many in Congress had reversed their earlier sympathetic stand on compensating annuitants for inflation and called for elimination of the 1 percent add-on. As inflation increased more rapidly, Congress felt that the add-on was too costly for the Federal government and overcompensated Federal annuitants. When the Senate was considering the budget for Fiscal Year 1977, Senator Ernest Hollings (D-SC) proposed an amendment to eliminate the add-on. Senator Lawton Chiles (D-FL) offered a substitute proposal which repealed the old indexing

system and provided for regular, semi-annual cost-of-living adjustments for civil service annuitants.

Under the Chiles substitute amendment, Federal retirees receive two cost-of-living adjustments per year. The change in the CPI is calculated on the first day of January and July and civil service annuities are increased by the movement in the price index during the previous six-month period. The adjustments become effective on March 1 and September 1 of each year. This system has remained in effect to the present time.

When the proposal was first made to eliminate the add-on, our union opposed the change on the grounds that the existing system was the fairest way to compensate retirees for the steadily rising rate of inflation and the administrative delays in receiving their cost of living adjustments. The one percent add-on represented the fairest attempt to keep annuities on a current pace with inflation instead of placing employees in the position of never being able to truly "catch up" with increases in the cost of living. This point was underscored in the recent issue brief entitled, "Federal Retirement Programs: Proposals to Change the Cost of Living Adjustments (COLA)," prepared by the Congressional Research Service of the Library of Congress.

The report points out that cost of living adjustments are intended as a counterweight against inflation which robs annuities of their value over time. According to the Congressional Research Service, COLA's "automatically return the value of annuities relative to a point on a standard measurement of price at entitlement." However, a real loss of purchasing power occurs despite the adjustments.

The semi-annual indexation system compensates retirees for movements in the CPI which have already occurred, but inflation continues to move during the three months between when the COLA is computed and when it is actually granted. Though retirees are eventually compensated for movements in the CPI during this 3 month period, the three month gap is never closed, causing a real loss in the actual purchasing power of annuitants. It was this gap which the one percent add-on was intended to correct.

The adoption of the semi-annual COLA system, therefore, represented a reduction in benefits for Federal retirees. Congress realized this when they repealed the one percent add-on, and agreed to the twice-a-year system of indexation as a compromise that would not as seriously erode the purchasing power of Federal annuitants as the simple elimination of the add-on and retention of the old computation methodology.

But, in addition to compensating retirees for the loss of the automatic one percent addition, the present system was intended to impose an order on the indexation process whereby retirees could know in advance when adjustments would be granted and plan their financial future accordingly. In return for the loss of a benefit, Federal workers received a commitment from Congress for a more rational program designed to guard the civil service retirement system against both inflation and political pressure to the greatest extent possible.

Unfortunately, Congress' commitment to the new system seriously wavered after only four years. In their deliberation over the budget for FY 1981, the Budget Committees of both houses

of Congress initially proposed to eliminate one of the cost-of-living adjustments under the civil service retirement system.

The Senate actually included the elimination of one COLA in its budget reconciliation package last year. However, when the roll was called on whether such a change would be made only for Fiscal Year 1981, the Senate voted 59 - 30 against abandoning the present system permanently.

Similarly, when the House review of the budget reconciliation bill went to the floor, the members of that body voted twice to keep the present COLA system intact by more than a three-to-one margin. Later, a Conference Committee voted to retain the semi-annual COLA and adopted other changes in the retirement system instead.

Though we had hoped that last year's deliberations and demonstration of support for the current system would put an end to the COLA debate, both house of Congress, with the support of the Reagan Administration, have this year initiated action to eliminate one of the adjustments. Once again, the same arguments that were put forth last year against the present system have been resurrected. We do not believe that they carry any more validity this year than they did a year ago simply because the pressures to reduce Federal spending are greater.

Besides citing the budgetary savings that the elimination of one of the COLA's would effect, critics of the present system continually assert the "unfairness" implicit in the Federal retirement system being indexed twice yearly while social security and other programs receive only one annual adjustment. They claim that Federal retirees already receive "generous" annuities and should not have such an additional advantage.

It would be both outrageous and tragic if Congress were to accept these arguments. Such assertions are grounded in half-truths and fail to consider either the real nature of the civil service retirement system or the human impact of the proposed change.

Those who would modify the present system fail to take into consideration the numerous budgetary savings that have already been achieved at the expense of Federal retirees. Besides the constant tinkering with the civil service retirement system by Congress which we have already detailed, the past five years have seen a steady erosion in retirement benefits.

In 1975, Congress restricted the retirement income tax credit, and in 1976 the sick pay tax exclusion was eliminated, placing an additional burden on many disabled retirees. Both of these changes affected retirees in the private and Federal sector.

One year later, Congress enacted the Social Security Financing Amendments of 1977 which contained a provision requiring that Federal retirees who were receiving survivor and dependent payments under the social security system have their benefits reduced by the amount of their civil service annuities. The rationale behind this provision was that individuals should not receive two annuities from the government, despite the fact that they qualify for such payments. Because the 1977 provision has not yet taken effect for most of those covered under it jurisdiction, we have no accurate estimate of how much this law will cost Federal annuitants.

Finally, in 1980, while Congress retained the semi-annual COLA formula, it enacted two other reductions in the civil service retirement system. Previously, Federal employees who retired after

a COLA had been implemented were permitted to have that adjustment included in the computation of their initial annuity payment. Known as the "look back provision," this provision was originally intended to dramatically reduce the incentive for employees to cluster their retirements immediately before the next adjustment was to take effect. It was eliminated, however, as part of the FY 1981 budget.

In addition, a Federal employee who retired midway between the two adjustments was formerly entitled to receive all of the first COLA that was granted after his/her retirement as if he/she had been on the rolls for the full six months. Last year, Congress approved a provision which would prorate a new retiree's first adjustment to reflect only those months in which he/she was actually retired. The Congressional Budget Office has estimated that the immediate savings to the government resulting from the elimination of these provisions total $23 million in FY 1981 and will reach $324 million by FY 1985.

As the recent history of the civil service retirement system indicates, the program has been a favorite target for those seeking to trim the Federal budget. Already millions of dollars have been saved from previous reductions in annuities available to former Federal workers. Although Congress once intended to insulate the system from undue political influence, it is clear that civil service retirement remains cruelly vulnerable to the prevailing political winds.

Unfortunately, by its constant tinkering with the retirement program, Congress is not just affecting figures on a ledger, it is tampering with the lives of thousands of retired workers.

We believe that after devoting a working lifetime to government service, Federal retirees have the right to expect a stable, sound retirement system and should be able to believe that their employer, the United States Government, will uphold the compact it made with each of them to provide a constant level of benefits.

We are deeply disappointed that many members of the House and Senate have consistently failed to recognize the essential differences between civil service retirement and other Federal programs, especially social security. By focusing attention solely on the differences in indexation, critics of the civil service retirement system are viewing only one component of a much larger picture. Such tunnel vision fails to promote fairness to either Federal retirees or the public or a true understanding of the differences between the two programs.

Civil service retirement is, and always has been, a staff retirement plan for Federal employees. Its purpose is to provide retirees with a livable annuity when their working years are over. The other Federal programs are not; in particular, Social Security is a social insurance program designed to supplement an individual's retirement income, but not to guarantee anyone a living annuity.

Interestingly enough, while numerous critics readily point out that civil service retirement is the only Federal program indexed on a semi-annual basis, they rarely mention that it is also a program subject to taxation at every level of government. While there are no precise estimates on how much of these annuities are paid into taxes, a reputable actuarial study has estimated that at least 10 percent of the average annuity goes into Federal taxes and another 5 percent into state and local taxes.

What does this mean in monetary terms? According to figures released by the Office of Personnel Management, by calculating the number of employee annuitants on the rolls and the average annuity, we find that civil service retirees pay over $114.5 million in Federal taxes. Survivor annuitants paid another $1.7 million. Taking these figures a step further, we can see that for every one million dollars eliminated from Federal annuities, the government loses $100,000 in revenue from taxes on their pension. We question whether or not the Administration and the Budget Committees have included these calculations in their budget estimates.

In addition to the direct reduction in retirement benefits enacted by prior Congresses, Federal annuities have also been reduced in a much more subtle manner. For five of the last six years, the Federal pay-setting system has not been allowed to function as intended. Instead of fostering the goal of pay comparability between Federal workers and private sector employees performing similar occupations, previous Administrations have imposed arbitrary caps on Federal pay for political and/or budgetary purposes. For Federal executives whose pay is reviewed by a special Commission every four years, the situation is even worse. These individuals have received no raises at all for four years, and Congress recently rejected a proposal to raise the statutory ceiling on their pay.

The cumulative effect of these limitations has caused General Schedule employees to fall nearly 10 percent behind the pay of their private sector counterparts over the last decade and

nearly 25 percent behind the rate of inflation. Federal executives trail their private sector counterparts by as much as 42 percent.

Since lower base pay results in the computations of lower annuities, these pay caps represent another hidden manner in which the costs of the civil service retirement program have been driven down. Over 100,000 annuitants entered the retirement rolls in FY 1980. These individuals felt the brunt of the pay caps in their last years of employment. Because the pensions of these employees were calculated on a base that was much lower than if the comparability system had been allowed to function, the government realized a savings of untold millions of dollars to the retirement system.

When the retirement program is viewed in this perspective, it is clear that Federal annuitants, whose average pension is slightly more than $10,000 a year, are not the beneficiaries of an overly generous system. Their retirement benefits have been reduced directly and indirectly over the past several years while they were active employees. These annuitants had their pay raises artificially restricted,and they were forced to pay more for their health and life insurance than most of their private sector counterparts. Working for the Federal government is not a financial paradise for anyone, nor is being a Federal annuitant a free pass to a retirement haven with countless hours of leisure luxury. Both active employees and annuitants have borne more than their share of sacrifices. On this basis, we must oppose any attempts to further limit benefits under the civil service retirement system, including those contained in S. 677, which is now before this Subcommittee.

S. 677 would retain the present system of semi-annual adjustments for annuitants 65 years of age or over. Annuitants between the ages of 60 and 64 would receive only the full March COLA, while those under 60 would receive a single adjustment at the rate of 50 percent of the full once a year COLA. At best, S. 677 is an attempt to soften the impact of the move to a once a year COLA. At worst, the proposal would result in a serious erosion of benefits under civil service retirement and could weaken some of the basic concepts that underly the system.

Since its inception, civil service retirement has followed the basic principle that the benefits earned and received should be related to years of service and salary and that the purchasing power of these benefits should be maintained during retirement. S. 677, however, departs from both of these principles. It establishes a new concept that those who are retired longer are in greater need of maintaining purchasing power on a more current basis than others. By so doing, the bill also provides that the length one has been retired will mean practically more than salary and length of service in the amount of annuity received by an individual. We believe that these effects of S. 677 - though they may be unintended - would erode the fundamental principle of the civil service retirement system.

One of our primary concerns with S. 677 is that it would create an arbitrary and, in our opinion, discriminatory class system of annuitants. The bill would set a new factor, age, as the key to how much protection against inflation a retiree will receive.

In the process, S. 677 will injure some whom it may not intend to affect.

S. 677 would have the following effects on those on the retirement rolls. Over 57 percent of employee and survivor annuitants would be eligible for two COLA's a year by virtue of their age. Twenty-one (21) percent of employee annuitants and 10.8 percent of survivor annuitants would receive one full adjustment a year. And 21.4 percent of the employee annuitants and 18.7 percent of the survivor annuitants would receive 1 COLA at the 50 percent rate.

The effects of this bill would be felt most severely by those who have not reached the age of 60 or 65, but who are no less in need of protection against inflation. These include:

- Children of deceased Federal retirees. Since it is highly unlikely that any of these individuals would be 65 years of age, virtually all will receive only one COLA or, more likely, 50 percent of an annual adjustment.

- Widows and Widowers with dependent children. As the survivors of deceased Federal retirees are also most likely to be younger than 65, they too will be denied full protection against inflation.

- Involuntary separations. Many employees accept early retirement when faced with a reduction-in-force, transfer, or abolishment of their positions. At a time when RIF's are scheduled to take place in many agencies, it is unfair to force separated employees to accept a lower annuity based solely on age.

- Personnel whose occupations require early retirement. Many employees in law enforcement and hazardous duty positions, air traffic controllers, and others are subject to mandatory retirement at age 55. Since Congress has deemed that the nature of these occupations requires that these employees leave their jobs at an early age, it does not make sense that these individuals should be victimized because of their age by receiving less than a full adjustment.

- Employees with long years of service. Similarly, Congress has mandated that long service in the government be recognized by the right to retire at age 55 (with 30 years) or 60 (with 20 or more years). Under S. 677, however, these retirees would be denied the benefits of full protection against inflation for no logical reason.

The loss of purchasing power that would be inflicted on these groups by S. 677 is very real. For the sake of an example, let us assume that a retiree receives a monthly annuity of $100.00. Let us also assume that inflation stays as its 1980 pace of 12 percent a year. Under the present system, receiving 2 COLA's a year, the annuitant would receive $1,722.60 per year. With only one full COLA, the annuitant receives $1,658.76, a decline of 3.8 percent in purchasing power. If the retiree receives only one-half of one adjustment, his/her annuity would be $1,320.96, a 6.4 percent loss of purchasing power. These figures are useful because the percentages can be applied to each $100 of annuity received by a retiree or survivor annuitant. As we discussed earlier in our statement, although an annuitant will eventually be compensated for this lost purchasing power, the dynamic movement of inflation will ensure that he or she will never fully keep pace.

In conclusion, we believe that the civil service retirement program has already been reduced enough over the years in various ways that have saved the government millions of dollars. We are extremely disappointed that Congress could consider tampering with the benefits of those who have served their government well and who, by virtue of their station in life, are unable to defend themselves against the effects of inflation.

We categorically reject the notion that Federal retirees must make even more sacrifices for the sake of the budget. We believe that the government must maintain its commitment to these individuals by retaining the present system of indexation of retirement benefits. We also believe that any changes such as those outlined in S. 677 are unjustified, grossly unfair, and must be rejected.

The preservation of the fundamental precepts behind the civil service retirement system is the real issue behind the COLA debate. Federal retirees and their survivors are now looking to Congress to preserve the integrity of their retirement system and maintain the U.S. Government's compact with these individuals. We hope that the Congress will act wisely and equitably.

Mr. Chairman, this completes my prepared statement. If there are any questions, my colleagues and I will be happy to answer them at this time.

Senator STEVENS. Our next witness is David Gusky, legislative director, National Federation of Federal Employees.

Mr. Gusky?

## TESTIMONY OF DAVID GUSKY, LEGISLATIVE DIRECTOR, NATIONAL FEDERATION OF FEDERAL EMPLOYEES

Mr. GUSKY. Thank you, Mr. Chairman.

The National Federation of Federal Employees appreciates this opportunity to present its views on S. 677, a bill to revise the system by which civil service annuities are adjusted to meet changes in the cost of living.

NFFE represents approximately 150,000 Federal employees, all of whom have a vital stake in the civil service retirement program. During this period of slow economic growth and rampant inflation, a major effort has evolved to reduce Federal expenditures, to equalize outlays with revenues. The theory, of course, is that a balanced budget would help greatly to restore a sound economy. The administration and Congress are now considering stringent measures to reduce fiscal year 1982 spending by billions of dollars.

The suggested costs would affect Federal employees and retirees through smaller pay raises, promotion and hiring freezes, possible layoffs, reduced workmen's compensation benefits, and the elimination of one of two annual annuity cost-of-living adjustments.

Because of the last item, NFFE can well understand the chairman's sponsorship of S. 677. We recognize that you are searching for an acceptable alternative to the semiannual COLA and the once-a-year system advocated by the administration and many of your congressional colleagues.

NFFE appreciates your efforts, particularly since the once-a-year system is a heavy favorite to be firmly in place at the end of this legislative session. We believe, however, that the semiannual COLA is a fair and necessary benefit. NFFE, therefore, must oppose S. 677 at this time and other, more severe proposals to weaken Federal retirees' protection against the ravages of inflation.

There are several reasons why NFFE believes the semiannual COLA should not be abandoned. First, we are generally opposed to the administration's draconian measures to reduce Federal spending. They are misdirected and, more importantly, will have little if any effect on our economy.

The sacrifices they ask of the poor, the handicapped, the unemployed, and, of course, Federal workers will serve no purpose other than to punish those already suffering economic and political abuse.

By itself, reducing the size and scope of the Federal budget would be nothing but a token gesture toward controlling inflation and spurring economic growth. In January, 1980, the Congressional Budget Office estimated that a $20 billion reduction would slow the inflation rate by about one-tenth of 1 percent.

Perhaps CBO's estimate is conservative, but even doubled, or tripled, the impact of the budget cuts obviously would be negligible.

It must be recognized that the growth in the Federal budget is largely a product of inflation, not a cause of it. Many programs for the disadvantaged as well as compensation systems for Federal

employees and retirees are protected against inflation through automatic cost-of-living increases and comparability raises.

When the inflation rate was fairly low, these escalators were viewed as fair and proper safeguards against the gradual rise in the cost of living.

However, now that inflation is out of control, through no fault of either the disadvantaged or civil servants, COLA's and comparability are considered excessive benefits which must be restrained. Ironically, these protections are being abandoned or weakened at the very moment they are most needed.

If the administration and Congress truly want to restrain inflation, they must concentrate their efforts in other areas, especially in formulating an effective national energy policy, not in cutting the Federal budget.

The Consumer Price Index, for example, rose 1 percent in February 1981, which is equivalent to an annual rise of 12 percent. The Bureau of Labor Statistics reports that 60 percent of the increase was due to just a 5 percent hike in energy costs that resulted from President Reagan's decision to decontrol oil prices. It is ludicrous to label reductions in food stamps, legal aid, unemployment benefits, student loans, cost-of-living adjustments and other essential Federal programs as the solution to high inflation while, at the same time, oil prices are being decontrolled.

NFFE's general opposition to the proposed budget reductions is a major reason why we oppose any change in annuity cost-of-living adjustments. Another, and equally important one, is that Federal retirees already have made their share of sacrifices in recent years.

In 1976, the so-called 1 percent add-on was eliminated in favor of the semiannual COLA. Also in that year, a change in law substantially increased taxes on Federal disability pensions. In 1977, thousands of civil service retirees lost eligibility for their social security benefits with the implementation of the social security spouse's offset.

Last year, the look-back formula was abolished for new retirees and a less liberal method was instituted for computing their initial cost-of-living adjustments.

From a cumulative standpoint, these changes have restricted the rise in value of the average Federal annuity, which is now a modest $10,000 a year before taxes. This is hardly the extravagant sum that is so often implied by the media and other critics of civil service retirement. Nevertheless, the system of semiannual COLA's is still targeted for extinction by virtually the same Congress that promised to maintain it in lieu of the 1 percent add-on, and by the very administration that promised to keep it during last year's Presidential campaign.

Aside from the system's expense—which, again, is a product, not a cause, of high inflation—the most frequent argument for eliminating twice-a-year adjustments is that because social security recipients receive only one annual COLA, Federal retirees should, too. The argument, of course, completely ignores the different aims of social security and that of civil service retirement. The former provides a minimum level of income security for the Nation's aged, disabled, and worker dependents. The latter, like most employee pension plans, is an important element of a specific compensation

program in that it serves as an incentive to recruit and retain qualified workers.

Its value lies in its promise to employees that a decent standard of living, fully protected against inflation, awaits them upon completion of their Government careers. This is especially true of civil service retirement since few other benefits in Federal service compare with those in private industry and pay comparability is now more a myth than reality.

The fact that social security benefits are adjusted for inflation only once a year should have no bearing on the type of indexing afforded civil service annuities. If the argument persists, however, that the COLA mechanisms should be identical, Congress should move to place social security on a twice-a-year basis. Only then would the value of both programs continue unabated.

In summary, the proposed elimination of the semi-annual COLA for Federal retirees cannot be justified, either as part of the administration's broad economic plan or for specific programatic reasons.

Federal retirees, like millions of other senior citizens, deserve and need to be safeguarded against the ravages of inflation. Congress believed this was necessary in 1976 when they established the semiannual system, and they should feel it is even more vital today with the inflation rate running in double figures.

It is doubtful that the administration's economic plan will have the impact promised by its supporters, but there is no doubt that the plan is being used as a license to cut essential social programs, including those that protect Federal beneficiaries against increases in the cost of living.

Certainly Government spending in a few areas is excessive and wasteful, but it should be cut back solely in those areas and for those reasons.

Again, Mr. Chairman, NFFE deeply appreciates what you are trying to accomplish with S. 677. By maintaining the twice-a-year COLA for retirees over age 65, a cost reduction would be achieved and those individuals most in need of financial protection would still receive it.

You have been one of our strongest and most effective allies on Capitol Hill, so it is no surprise that in the face of overwhelming odds, you have suggested this alternative.

At this time, however, NFFE must oppose its enactment.

That concludes my statement. I will be happy to answer any questions.

Senator STEVENS. Thank you very much.

I assume you would agree with the previous witnesses that if we have to choose between annualization and S. 677, we might as well take annualization. Is that correct?

Mr. GUSKY. I wish we could support your bill, but we would probably support annualization.

Senator STEVENS. Thank you very much.

Mr. GUSKY. Thank you, Mr. Chairman.

Senator STEVENS. Thank you all.

The committee will stand in recess.

[Whereupon, at 10:24 a.m., the committee stood in recess, subject to the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

97TH CONGRESS
1ST SESSION

# S. 677

To amend chapter 83 of title 5 of the United States Code to provide an equitable system of cost-of-living adjustments for civil service annuitants, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 10 (legislative day, FEBRUARY 16), 1981

Mr. STEVENS introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

# A BILL

To amend chapter 83 of title 5 of the United States Code to provide an equitable system of cost-of-living adjustments for civil service annuitants, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Civil Service Retirement Cost-of-Living Adjustment Act of 1981".

SEC. 2. (a) Subsection (b) of section 8340 of title 5, United States Code, is amended to read as follows:

"(b)(1) Except as provided in paragraph (2)—

"(A) effective March 1 of each calendar year, each annuity payable from the Fund which has a commencing date not later than such March 1, and—

"(i) which is payable to an employee or Member (or widow or widower thereof) who has not attained the age of 65 on or before such March 1 shall be increased by the percentage increase in the price index published for December of the preceding calendar year over such index for December of the second preceding calendar year, and

"(ii) which is payable to an employee or Member (or widow or widower thereof) who has attained the age of 65 on or before such March 1 shall be increased by the percentage increase in the price index published for December of the preceding calendar year over such index for June of the preceding calendar year; and

"(B) effective September 1 of each year, each annuity payable from the Fund which has a commencing date not later than such September 1 and which is payable to an employee or Member (or widow or widower thereof) who has attained the age of 65 on or before such September 1 shall be increased by the percentage increase in the price index published for June

of such year over such index for December of the preceding year.

"(2) In the case of an annuity payable from the Fund to an employee or Member (or widow or widower thereof) who has not attained the age of 60 on or before March 1 of the applicable year, paragraph (1)(A)(i) shall be applied by inserting '50 percent of' before 'the percentage increase'.

"(3) Any percent change in an annuity under this subsection shall be adjusted to the nearest 1/10 of 1 percent.".

(b)(1) Subparagraph (A) of section 8340(c)(1) of title 5, United States Code, is amended by inserting "(1/12 if such first increase is determined under subsection (b)(1)(A)(i))" after "1/6".

(2) Paragraph (3) of section 8340(c) of title 5, United States Code, is amended by inserting "subsection (b)(1)(A)(i) of" before "this section" the first place it appears.

SEC. 3. The amendments made by this Act shall apply to any increase in any annuity taking effect on or after the date of the enactment of this Act.

AMERICAN
FOREIGN SERVICE
ASSOCIATION

2101 E Street, Northwest Washington, D. C. 20037 • 338-4045

March 31, 1981

APR 0 1 RECD

Senator Ted Stevens, Chairman,
Civil Service, Post Office, and
General Services Subcommittee
Room 57 - CHA
128 C Street, N.E.,
Washington, D.C. 20510

Dear Senator Stevens:

We wish to record our dismay over the provision in S. 677 which would limit federal retirees under age 60 to a single cost-of-living adjustment annually which would equal only half of the increase in the consumer price index. Retirees 60 years of age and over would have their annuities adjusted to reflect the full annual increase in the price index.

This provision, if enacted into law, would do much more than restrict one age group of retirees to a partial cost-of-living adjustment. It would undermine one of the fundamental premises upon which the foreign service personnel system is based.

Here is the reason why. As you may know, the foreign service personnel system is structured on the "up and out" principle. It operates effectively only because employees who are not selected for promotion to the senior ranks are authorized by law to retire voluntarily after age fifty with twenty years' creditable service. In addition to the pyramidal personnel structure, the nature of foreign service life, entailing as it does periods of unusual hardship, high risk, and personal sacrifice for both employees and their families, has consistently led Congress to reaffirm this retirement provision, most recently through the enactment of the Foreign Service Act of 1980 in November of last year.

As a result, approximately 30% of all foreign service retirees are under age 60. To penalize these persons and those who will follow by denying them the full cost-of-living adjustment available to all other retirees would not only represent a serious inequity; it would damage irreparably the very basis upon which the foreign service personnel system has operated over the years.

Since the foreign service, like the military, depends upon an "up or out" system, the result of a reduction in voluntary retirements must be an equal rise in the number of mandatory separations. People selected out as a result would receive only the greatly curtailed annuity. Unlike the Senior Civil Service they cannot "parachute" to a lower grade. This would be grossly unfair to loyal and competent U. S. Government employees who have suffered hardship and risk in the service of their country around the world.

Accordingly, we respectfully urge that paragraph (3)(F) be stricken from S. 677.

Sincerely yours,

Kenneth J. Blaeckle
President

AMERICAN POSTAL WORKERS UNION, AFL-CIO
817 14TH STREET, N. W., WASHINGTON 5, D. C.

STATEMENT OF THE
AMERICAN POSTAL WORKERS UNION, AFL-CIO
S.677 REDUCTION OF CERTAIN CIVIL SERVICE
RETIREE COLA BENEFITS
PRESENTED TO THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE, AND
GENERAL SERVICES
UNITED STATES SENATE
APRIL 1, 1981

Mr. Chairman and Members of the Subcommittee:

My name is Moe Biller and I am the elected General President of the American Postal Workers Union, AFL-CIO.

Our Union membership numbers more than a quarter of a million men and women and everyone is a taxpayer. Our workers are employed in every city, town and hamlet in the U.S.A., the District of Columbia, Puerto Rico, the Virgin Islands and Guam. We are an industrial union representing clerks, maintenance and motor vehicle employees, special delivery messengers, and employees at U. S. Postal Service depositories, postal data centers and the mail equipment shop.

This testimony is presented on behalf of our Union concerning S.677, which allegedly proposes "To provide an equitable system of cost-of-living adjustments for civil service annuitants". I say "allegedly", because it is the opinion of the American Postal Workers Union that regardless of good intentions or reluctance to change the existing equitable bi-annual adjustments of retiree COLA, S.677 would in fact substitute an inequitable, discriminatory and totally unacceptable formula for adjusting annuities in the future.

The legislation before us would dramatically alter statutory guarantees which our members and retirees consider as an irrevocable "condition of employment". They have always "paid the freight" as participants in the Civil Service Retirement System, including every penny required of them by Congress. This was not always true of the Federal Government. Now, once again, Congress, in the name of "budgetary expediency", seeks to deprive those who have labored long and hard in the Postal Service and Federal Government of their just rewards at the time of their retirement. That is, they will suffer a sharply reduced annuity income and an inability to cope with the devastation of inflation of which they are not the source, but rather,

the victims.

At the present time, Civil Service retirees and survivors have their annuities adjusted twice a year in September and March, based on CPI percentage increases in the Consumer Price Index during the intervening six-month periods. Senate Bill 677 would destroy this reasonable and guaranteed benefit level for Federal civilian retirees by establishing a new system as a so-called "alternative".

Under S.677:

> A federal employee who retires and receives a Civil Service annuity before age 60 would have his or her annuity adjusted only once a year and at only 50% of the CPI, and
> The same retiree between ages 60 and 65 would receive a full CPI adjustment but only once a year, and
> Finally, at age 65 or over, if the postal worker retiree lives that long, he or she then (and only then) will receive the present statutory full cost-of-living adjustment each 6 months.

Mr. Chairman, and Members of the Committee, S. 677 proposes that postal and Federal workers again be denied a very important contractual obligation of the United States Government and the Congress; namely, "survival" in their senior and declining years with a modest assurance that their monthly annuity checks will not be continually ravaged by run-away inflation.

We found ourselves agreeing and disagreeing with the distinguished Chairman of this Committee when he introduced S.677 on March 10, 1981. Over the years, the Chairman has been a true friend of Federal employees and retirees. We agreed when the Chairman advised his Senate colleagues that, "Last year I fought strenously to save the semi-annual adjustment formula and we won". The Chairman, then a Minority Member of the Senate, did precisely that; and we applauded him for his action.

We also agreed with a statement he made at the same time that,

> "I feel that the Federal retirement systems are of the most worthy Federal programs. Federal retirement is not controversial. It is not a program that produces intangible results. It is a

commitment, a covenant, to the people of this country who devoted their careers to Federal service. Retirement benefits are a part of compensation. They are, in a sense, deferred wages and act as an allurement to individuals to accept employment."

We cannot agree, however, that retired men and women of the postal and Government service should be required to subsidize their employer at a time when they most need all of their sharply reduced income, including semi-annual COLA, upon retirement from a full salary position with the same government. Who is to say that a retiree or survivor at age 55, 56, or later, does not need protection against inflation-- as much as those age 65 or older? It would appear such arbitrary judgment can be best left to the good Lord, and certainly not to mere mortals.

Such debilitating changes proposed by S.677, in addition to treating retirees unfairly, would certainly have a chilling effect on postal workers. Those same workers are the ones who, for many, varied and legitimate reasons have planned retirement after 30 years (or more) of hard work at ages between 55 and 65. Why should they arbitrarily be denied

the opportunity, or at least be strongly discouraged, from making a free choice as to their retirement date - after satisfying all the requirements of existing law?

It is claimed that "savings in the first full year of implementation will be approximately $350 million, as compared to savings of $510 million, through simple annualizations of annuities. However, savings in the out years through the enactment of this bill will be considerably more than that generated by annualization". We note that the above is the Chairman's "understanding", and while we do not have data sources immediately available to us for a cost analysis, it would appear that the S.677 projections of savings may be considerably more- particularly in the "out years". We will be analyzing these projections ourselves to the extent possible.

However, it is important to understand that "savings" to the Government and/or Civil Service fund would be generated from only one source, retired federal employees and survivors who can least afford to pay the tremendous price of inflation and the resulting hardships. The average postal retiree is probably receiving an annuity of about $10,000 per year, which is more than one-half of what his/her salary would be at the present time.

This amount of retirement income is almost $5,000 less than the lowest income estimate by the B.L.S. needed by an Urban Family Budget. In addition, federal, state, and local income taxes must also be paid, compromising the retiree's net income. This alone is a traumatic experience. There is no formula or benefit even under existing law which permits the retiree to retain his or her standard of living after retirement. The COLA changes proposed in S.677 would only make financial "survival" of retirees and survivors even more difficult.

All of this, Mr. Chairman, when the Civil Service Retirement Fund reports that:

> It has total assets of $64,276,100,950, with receipts last year from all sources, of $20.5 billion and disbursements of only $12.6 billion, and
>
> The independent Board of Actuaries of the Civil Service System has projected that under the present financing method, receipts of the Civil Service fund will exceed disbursements for at least the next 100 years. Also, Mr. Chairman, receipts have exceeded disbursements in each of the 60 years of the fund's existence.

Wouldn't it be a great relief to the Congress, the White House and all Americans if the same could be said for the Social Security System" If its receipts and disbursements could give a 100-year guarantee of financial solvency?

Mr. Chariman, we recognize that promises, whether made by the Congress, the President or candidates for political office, unfortunately are often ignored or broken. This does nothing to provide workers, who are also voters, with reason to support these people when election time rolls around.

I refer you to the statement issued on October 3, 1980 by Ronald Reagan, candidate for the Presidency of the United States concerning Civil Service retirement benefits, which I quote in part;

> The benefits of all retired persons are seriously threatened unless inflation adjustments are made in a timely fashion.
>
> The present civil service retirement law properly provides for a cost-of-living adjustment to protect retirees from the destruction of the value of their benefit payments. The adjustment is made semi-annually.
>
> In an era of sustained high inflation rates, it is not reasonable to expect retired federal civil servants to absorb a 10% decline in the purchasing power of their benefit checks before an adjustment

is made to reflect the higher cost-of living.

I do not favor abandoning the present semi-annual indexing.

Mr. Chairman and Members of the Committee, the American Postal Workers Union believes that commitments made by the Congress and the President of the United States should be honored. Senate Bill 677 would renege on a statutory commitment made by the Congress and a promise originally made by the President to retirees and survivors, as well as to active postal and federal employees. We urge this Committee to reject S.677 and stand against any reduction in retires 100% COLA bi-annual benefits.

Thank you for the opportunity to present this statement. If I can be of any further assistance, or you wish to have me respond to any questions you may have concerning my statement, please feel free to contact me. I shall be glad to assist you in any way possible.

PREPARED STATEMENT OF DOUGLAS FARBROTHER, ACTING DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR PROGRAM MANAGEMENT

The Department of Defense is pleased to present to the Committee this statement on the possible impact on the military of S. 677.

While the Department of Defense supports efforts to reduce the cost of government we are concerned that the proposed amendment could seriously affect our efforts to improve military retention. Our concern arises because of the high probability that the provisions of S. 677 would be applied to military retirees.

This is so because last year's DoD Authorization Act for Fiscal Year 1981 contained a contingent amendment to Title 10 concerning cost of living adjustments to military retired pay. This amendment provides that military retired pay shall be adjusted at the same time and in the same percentage as civilian annuities are adjusted under title 5. The amendment will take effect on August 31, 1981, only if title 5 is amended to provide a once-a-year cost of living adjustment to civilian annuities. If S. 677 is enacted, the contingent amendment concerning the military retired and retainer pay adjustment may become effective since S. 677 includes, at least to some extent, a once-a-year cost of living adjustment to civilian annuities. More important, since the percentage of military retired and retainer pay adjustments is tied to the percentage of adjustments to civilian annuities, the military retired pay system could be severely disrupted -- because military retirees may be restricted to the 50% cost of living adjustment provided for civilians retired before age 60. If such is the case, and the application of the statutes is somewhat unclear in this respect, it would cause severe hardship among military retirees.

For example, the average enlisted man retires with 20 years of service at age 39, at a 5% annual inflation rate, would see the real value of his annuity reduced 40% by the time he reaches the age of 60. Likewise, the average officer retires with 23 years of service at age 47, and would see his annuity reduced by 27%. As is illustrated in the chart below, military retirement would be seriously eroded by the time the full CPI protection came into effect at age 60.

EFFECT ON MILITARY RETIRED PAY OF HALF CPI INCREASE ONCE A YEAR

| | 1981 RETIREES | | | |
|---|---|---|---|---|
| Rank | Years of Service | Age at Retirement | Monthly Retired Pay in 1981 | Monthly Retired Pay at Age 60 expressed in constant 1981 dollars (and as a % of original amount) |
| E-7 | 20 | 39 | $610 | $363 (60%) |
| O-5 | 23 | 47 | $1,580 | $1,146 (73%) |

The Administration's legislative proposal to replace the semiannual cost of living adjustments with a single annual adjustment for military and Civil Service retirees would not erode the real value of monthly retired pay. It would provide full CPI protection to all retired personnel, regardless of age, with the same frequency afforded under social security and virtually every other federal benefit program that adjusts automatically for inflation.

In summary, the Department of Defense supports the Administration proposal. We oppose enactment of S677, if enactment, especially, upon the military, would be severe.

Tony R. Huerta
Executive Vice President
Francis J. Conners
Vice President
Richard P. O'Connell
Secretary-Treasurer
Ronald L. Hughes
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George Davis, Jr.
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STATEMENT OF
VINCENT R. SOMBROTTO, PRESIDENT
NATIONAL ASSOCIATION OF LETTER CARRIERS, AFL-CIO

TO THE

SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE, AND GENERAL SERVICES
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON S.677
AN ALTERNATIVE TO ANNUALIZING
THE COST OF LIVING ADJUSTMENTS
ON FEDERAL RETIREMENT

April 13, 1981

I welcome this opportunity to transmit to you the views of the National Association of Letter Carriers, AFL-CIO, on S.677. The National Association of Letter Carriers is a labor organization consisting of almost 240,000 members and is the exclusive bargaining agent of City Letter Carriers employed by the U. S. Postal Service.

Let me begin by thanking the diatinguished Chairman of this Subcommittee for his efforts to fashion an alternative to the Administration's proposal to eliminate one of the present twice-a-year cost-of-living adjustments for postal and federal retirees. While the National Association of Letter Carriers strongly opposes S.677, we recognize that

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the Chairman introduced this Bill "with great reluctance" and we appreciate his continued efforts on behalf of both this nation's corps of Letter Carriers, as well as all other postal and federal workers and retirees.

The National Association of Letter Carriers favors continuation of the present procedure of adjusting the annuities of postal and federal retirees by increases in the cost-of-living on a semi-annual basis. We are, therefore, opposed to both S.677 as well as the Administration's equally severe, if somewhat less complex, proposal to eliminate one of the semi-annual adjustments. We take this position for the following reasons:

- Retirees are the victims -- not the villians -- of rampaging inflation in this country. Even with the present adjustment procedure, there is a three-month gap between the measurement of change in the cost-of-living and the adjustment in annuities which reflect this change. To eliminate one of the present twice-a-year cost-of-living adjustments would delay this adjustment for increases in the cost-of-living to an even greater extent -- adding an even greater burden to the retiree at a time when he or she is already on a limited income.

- Not only would elimination of one of the twice-a-year cost-of-living adjustments result in extending the period of time during which the retiree would clearly be "behind"

increases in the cost-of-living, but perhaps more importantly, the nature of compounding the cost-of-living adjustments would mean that the retiree would never catch up. I should add here, that this is even more true of S.677 which provides for a three-tiered cost-of-living adjustment schedule -- one annual adjustment at fifty percent of the increase in the Consumer Price Index for annuitants between the ages of fifty-five and sixty; one adjustment at the full increase in the Consumer Price Index for annuitants between the ages of sixty and sixty-five; and continuation of full semi-annual adjustments for annuitants sixty-five years of age and over. The reason for this is because cost-of-living adjustments for postal and federal retirees are computed by applying a percentage against the then-existing base annuity. Consequently, any proposal which reduces either the frequency or the size of the adjustment -- or both -- will result in a lower base to be used when later adjustments are computed.

• Any changes in the present twice-a-year adjustment procedure would represent a breach of Congress' commitment to minimize the impact of rapid inflation upon postal and federal retirees. Without tracing the entire history of cost-of-living adjustment for postal and federal annuitants, let me simply state here that in 1976, when the Congress repealed the so-called one percent "kicker," Congress also

committed itself to provide adequate "inflation protection" for individuals covered by the Civil Service Retirement System by establishing cost-of-living adjustments on a semi-annual basis. Any deterioration in the frequency and adequacy of cost-of-living protection by the Congress would represent a violation of the commitment Congress entered into in 1976.

• In addition to these arguments expressing the opposition of the National Association of Letter Carriers to any proposals which would reduce the frequency of cost-of-living adjustments for postal and federal annuitants, allow me to express one particular objection to S.677. By reducing the amount and frequency of adjustments for annuitants between the ages of fifty-five and sixty and the frequency of adjustments for annuitants between the ages of sixty and sixty-five, S.677 penalizes employees who retired early. This obviously includes individuals who, because of hazardous duty, are required by statute to retire well before age sixty-five. It also includes long-service employees who, because of their longevity, have had the option of retiring with full benefits prior to age sixty-five.

Perhaps less obviously, S.677 also penalizes those postal and federal retirees who -- because of the physical demands of their employment -- are unable to continue working until age sixty-five. Here I am thinking primarily, although

not exclusively, of the City Delivery Letter Carrier whose job extolls a physical toll which grows heavier with each passing year. It is no accident that the overwhelming majority of Letter Carriers have retired as close to age fifty-five as their terms of employment allow.

I wish to thank the Chairman and the members of this Subcommittee for granting me this opportunity to transmit to you the views of the National Association of Letter Carriers, AFL-CIO.